No. 88-1649

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1988

L & B CORPORATION, a Nebraska Corporation

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

LARRY A. LARSEN and BETTY J. LARSEN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ESTATE OF HOWARD C. LARSEN, DECEASED, MAXINE J. LARSEN, EXECUTRIX and MAXINE J. LARSEN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PAUL A. RAUTH
MARKS & CLARE
American Charter Center
1623 Farnam Street, Suite 900
Omaha, Nebraska 68102
(402) 422-0900

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTIONS PRESENTED FOR REVIEW

1. Do the Petitioners' refrigerated structures qualify as "section 38 property," as defined in the Internal Revenue Code of 1954, as amended, because:

(a) they are "other tangible property" used as an integral part of production, and

(b) they are not buildings?

2. Did the Court of Appeals err in setting aside the Tax Court's finding that the Petitioners' refrigerated structures "do not function as buildings" (and, therefore, are not buildings) without having determined that such finding was clearly erroneous, as required by Federal Rule of Civil Procedure 52(a)?

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The Petitioners, L & B Corporation,(1) Larry A. Larsen and Betty J. Larsen, Estate of Howard C. Larsen, Deceased, Maxine J. Larsen, Executrix, and Maxine J. Larsen, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit in this case.

(1) Entities affiliated with L & B Corporation (now known as Millard Refrigerated Services, Inc.) include these corporations: Millard Warehouse, Inc; Lac Seul Sporting Club, Inc.; Freezer Services, Inc. (Iowa); Millard Warehouse Aviation, Inc.; Millard Warehouse, Batavia, Inc.; M.P.S., Inc.;

(Continued on following page)

OPINIONS IN THE COURTS BELOW

The opinion of the Court of Appeals (App. A, infra, 1-21) is reported at 862 F.2d 667. The opinion of the United States Tax Court (App. D, infra, 25-59) is reported at 88 T.C. 744.

JURISDICTION

Judgment of the Court of Appeals was entered on November 25, 1988. (App. B, infra, 22, 23) The order of the Court of Appeals denying the Petition for Rehearing was entered on January 6, 1989 (App. C, infra, 24), and this petition for certiorari was filed within 90 days of that date. This Court has jurisdiction under 28 U.S.C. §1254(1).

(Continued from previous page)

Iowa-Nebraska By-Products, Inc.; Millard Warehouse Enterprises, Inc.; Millard Refrigerated Services-S.O., Inc.; L.A.L., Inc.; Larsen Realty, Inc.; Millard Refrigerated Services-Des Moines, Inc.; Millard Refrigerated Services-Omaha, Inc.; Millard Refrigerated Services-Denison, Inc.; Millard Refrigerated Services-Grand Island, Inc.; Millard Refrigerated Services-Iowa City, Inc.; Millard Refrigerated Services-Dodge City, Inc.; Millard Refrigerated Services-Friona, Inc.; Millard Refrigerated Services-Greeley, Inc.; Millard Refrigerated Services-M.A., Inc., and these partnerships: Larsen Realty; Millard Warehouse, Des Moines; Millard Warehouse, Denison; Millard Warehouse, Iowa City; Millard Warehouse, Omaha; Millard Warehouse, Grand Island; Millard Warehouse, Friona; Millard Warehouse, Dodge City

STATUTES AND REGULATIONS INVOLVED

Statutes:

26 U.S.C. §38 (1980):

§38. Investment in certain depreciable property

(a) General rule. – There shall be allowed, as a credit against the tax imposed by this chapter, the amount determined under subpart B of this part.

(b) Regulations. – The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section and subpart B.

26 U.S.C. §48(a)(1) (1980):

§48. Definitions; special rules

(a) Section 38 property. -

(1) In general. – Except as provided in this subsection, the term "section 38 property" means -

(A) tangible personal property (other than an air conditioning or heating unit), or

(B) other tangible property (not including a building and its structural components) but only if such property -

(i) is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

(ii) constitutes a research facility used in connection with any of the activities referred to in clause (i), or

(iii) constitutes a facility used in connection with any of the activities referred to in clause (i) for the bulk storage of fungible commodities (including commodities in a liquid or gaseous state), or

(C) elevators and escalators, but only if -

(i) the construction, reconstruction, or erection of the elevator or escalator is completed by the taxpayer after June 30, 1963, or

(ii) the elevator or escalator is acquired after June 30, 1963, and the original use of such elevator or escalator commences with the taxpayer and commences after such date, or

(D) single purpose agricultural or horticultural structures; or

(E) in the case of a qualified rehabilitated building, that portion of the basis which is attributable to qualified rehabilitation expenditures (within the meaning of subsection (g)).

Such term includes only property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 3 years or more.

26 U.S.C. §168(b)(3)(A) (1988):

§168. Accelerated cost recovery system

(b) Applicable depreciation method. – for purposes of this section -

(1) * * *

(2) * * *

(3) Property to which straight line method applies – The applicable depreciation method shall be the straight line method in the case of the following property:

(A) Non-residental real property.

26 U.S.C. §168(c) (1988):

§168. Accelerated cost recovery system

(c) Applicable recovery period. For purposes of this section, the applicable recovery period shall be determined in accordance with the following table:

In the case of:	The applicable recovery period is
* * *	* * *
Non-residental real property	31.5 years

26 U.S.C. §168(e)(2)(B) (1988):

> §168. Accelerated cost recovery system
>
> (e) Classification of property. For purposes of this section -
>
> (2) residential rental or non-residential real property. -
>
> (A) * * *
>
> (B) Non-residental real property. – The term "non-residental real property" means section 1250 property which is not -
>
> (i) Residential real property, or
>
> (ii) Property with a class life of less than 7.5 years.

Regulations:

Treas. Reg. §1.48-1(e)(1) (1980)

(The text of the regulation cited above, for the year indicated, is set forth at App. F, infra, 65, 66)

STATEMENT OF THE CASE

The jurisdiction of the United States Tax Court (hereinafter "Tax Court") was invoked by the Petitioners under 26 U.S.C. §6213(a), by the filing of three cases in the Tax Court requesting redetermination of income tax deficiencies for the calendar years 1979 and 1980. These cases were consolidated for trial and were tried to the Tax Court without a jury.

During 1979 and 1980 the Petitioners, operating through various partnerships, constructed and placed in service, at several locations in Iowa and Nebraska, facilities consisting of refrigerated structures and additions

thereto, together with loading docks, paved truck turnarounds and, in some instances, railroad trackage. The refrigerated structures were designed, constructed and used to rapidly freeze freshly slaughtered meat to an extremely low temperature, and also to provide for frozen and cold storage of meat and other products.

On their tax returns for 1979 and 1980, the Petitioners claimed, as a credit against their income taxes, the investment tax credit which was allowed under 26 U.S.C. §§38 and 48, as then in effect, (hereinafter "ITC") with respect to the entire cost of their refrigerated structures, which included the cost of the refrigeration equipment incorporated into these structures. On those tax returns, the Petitioners used the 200% declining balance method of depreciation with a seven year useful life, in computing depreciation on those structures.

During audit of those returns, the Commissioner of Internal Revenue (hereinafter "Commissioner") allocated a part of the total cost of these refrigerated structures to the refrigeration equipment and the remainder of the cost to the structures themselves. The Commissioner then treated the refrigeration equipment as "tangible personal property" and allowed ITC on the same as "section 38 property" under 26 U.S.C. 48(a)(l)(A). However, the Commissioner disallowed ITC on the costs he had allocated to the structures themselves, stating that these structures were "buildings" which were not "section 38 property" and therefore not subject to ITC. For the same reason, the Commissioner also disallowed the 200% declining balance method of depreciation on these refrigerated structures and extended their useful life.

Following trial, the Tax Court determined that these refrigerated structures were "not buildings" but that their useful life should be 15 years. (App. 59) The Tax Court did not allow the 200% declining balance method of depreciation. (App. 57)

The trial record shows that a "refrigerated structure" is made up of two interdependent and indispensable components, the first of which is a sealed, heavily insulated air chamber, with the second being the refrigeration equipment. The refrigeration equipment includes evaporators and high velocity electric fans located *within* the air chamber, plus compressors electric motors, and related equipment, located *outside* the air chamber. These items of equipment inside and outside of the air chamber are connected by piping containing the refrigerant (ammonia). While in operation, the refrigeration equipment causes the ammonia to be first compressed, outside the air chamber, and then expanded within the air chamber, resulting in the extraction of heat from the meat within the chamber.

The trial record further establishes that the principal function of these refrigerated structures – the freezing of meat – is accomplished by removing substantially all of the heat from the meat, and finally transferring this heat to the air outside of the air chamber. Stating it sequentially, the heat first transfers from the meat to the extremely cold air within the air chamber, as it is blown over and around the meat, and then from the air to the refrigerant contained within the refrigeration equipment. The refrigerant, having absorbed the heat, is then circulated to the outside of the chamber, where the heat is dissipated from the refrigerant into the outside air. This

process of transferring heat from the meat to the outside air continues so long as the refrigeration equipment is operating and the air chamber remains closed.

The trial record also shows that the air chamber alone cannot cause the meat to freeze, nor can the refrigeration equipment, without the air chamber, cause the meat to freeze. The testimony at trial established that these "refrigerated structures" are essentially very large deep freezers which function very much like a home deep freezer. They are operated on a continuous basis, twenty four hours a day.

In order to determine whether the refrigerated structures were "section 38 property," as defined in 26 U.S.C. §48(a)(1)(B)(i), the Tax Court had to determine both:

(1) that the refrigerated structures are not buildings, and

(2) that the refrigerated structures are used as an integral part of production.

The Tax Court determined that these refrigerated structures were "not buildings," but also determined that they were not used as an integral part of production.

The Court of Appeals found that the structures were "buildings," and reversed the Tax Court on that point. Having determined that the structures were "buildings," the Court of Appeals had no need to determine whether or not the structures were used as an integral part of production. It nevertheless made such a determination when it found, *de novo*, that the "structures" do not perform the function of freezing the meat. (App. A, infra, 15)

The Tax Court, in determining how these refrigerated structures function, found that the facilities served two functions, *first*, meat that was "hot," i.e., freshly cut, was frozen, and *second*, meat and other products were stored at cold to extremely cold temperatures. (App. 37 and 47) Having found these to be their functions, the Tax Court held that these refrigerated structures are not buildings. (App. 48)

In its opinion, the United States Court of Appeals for the Eighth Circuit (hereinafter "Court of Appeals") stated that it and other courts have used a two-part test to determine whether or not a particular structure is a building. This test requires the Court to determine (1) whether the structure resembles a building, and (2) whether the structure functions as a building. (App. 8) Both the Tax Court and the Court of Appeals concurred in finding, under the first part of the above-mentioned test, that the structures look like buildings. Petitioners do not challenge that finding in this Court.

With respect to "function," the second part of the above-mentioned test, the Court of Appeals disagreed with the Tax Court's conclusion, believing instead that the refrigerated structures do function as buildings. (App. 9) The Court of Appeals stated that the Tax Court applied an unduly restrictive version of the function test in this case. (App. 9) The Tax Court had determined that the refrigerated structures do not function as buildings because:

> "the evidence does not indicate that significant human activity, of quantity or quality, took place in the refrigerated structures. The structures did not

function as working space for employees and equipment * * *." (App. 47)

The Court of Appeals adopted a somewhat different function test stating that:

> "Thus, a structure functions as a 'building' if it provides shelter for significant machine or animal activity or if it provides working space for humans. Under this broader concept of 'function,' the refrigerated structures constitute 'buildings. * * * The refrigerated structures provide shelter for the refrigeration equipment and provide working space for the employees * * *. Applying the test above, we find that these structures function as 'buildings.' " (App. 12)

In its opinion, the Court of Appeals recognized that several courts have applied a narrower function test in determining whether refrigerated structures constitute "buildings." (App. 13) It further acknowledged that it had departed from the narrow definition of "buildings" used by the Tax Court and several other circuits. (App. 12, n.8)

In further discussion as to whether or not these structures were essentially an item of machinery or equipment, and therefore not buildings, under the definition of "building" established by Section 1.48-1(e)(1) of the Treasury Regulations, the Court of Appeals stated:

> "After reviewing the record, we find that the *structures* in this case do not perform the function of freezing the meat. Rather, they were designed to withstand the cold temperatures produced by the compressor engines, the refrigeration coils, and the blowers. The insulation helped to maintain the conditions in the *structure;* the *structure* itself did not create those conditions. Based on these facts, it appears that

> the *structures* are sufficiently separate from the equipment that it cannot fairly be said that the structures performed the function." (App. 14, 15) (emphasis added)

Here the Court of Appeals was viewing the "structure" separately from the equipment, rather than viewing the entire functioning unit as a "refrigerated structure" consisting of the air chamber and the refrigeration equipment, all of which, as an operating unit, performs the function of freezing the meat.

In Part II B of its opinion, the Court of Appeals recognized the "clearly erroneous" test under F.R.C.P. 52(a) when it addressed the issue of whether the blast freezing of meat constitutes manufacturing or production, pursuant to 26 U.S.C. § 48(a)(1)(B)(i). (App. 17-21) Since the Treasury Regulations define "production," and state that property used as an integral part of the "processing of meat" will be "section 38 property," the Court of Appeals had to address the question of whether or not the "freezing of meat" constituted the "processing of meat." (App. 17, 18) In footnote 12 to its opinion the Court of Appeals stated that this issue involves an analysis of fact and law, and that in mixed law-fact questions involving interpretations of the Internal Revenue Code, the Court will only reverse if the lower Court's finding is clearly erroneous. (App. 18, n.12) The Court of Appeals, without specifically mentioning F.R.C.P. 52(a), correctly applied that rule and determined that the Tax Court "clearly erred" in finding that the subject property was not used as an integral part of processing meat. (App. 18) After referring to the testimony of three experts, all of whom essentially said that the freezing of meat is the processing of meat, the Court of Appeals concluded: "Thus, blast freezing constitutes the processing of meat

and the Tax Court clearly erred in determining otherwise." (App. 18-20)

Nevertheless, in reversing the Tax Court's determination on the issue of the "function" of Petitioners' refrigerated structures and its determination that they "are not buildings," the Court of Appeals has made no determination that the findings of the Tax Court are "clearly erroneous." This omission is unexplained, for nowhere in its opinion does the Court of Appeals state that the "clearly erroneous" test of F.R.C.P. 52(a) is inapplicable to its reversal of the Tax Court's findings on the fact question of whether or not these refrigerated structures "function" as "buildings," and on the ultimate question of whether or not they are buildings.

REASONS FOR GRANTING THE WRIT

1. THE DECISION OF THE COURT OF APPEALS AS TO THE "FUNCTION" OF THE PETITIONERS' REFRIGERATED STRUCTURES IS DIRECTLY IN CONFLICT WITH THE DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT IN *MUNFORD, INC. V. COMMISSIONER OF INTERNAL REVENUE*, 849 F.2d 1398 (1988) AND IS ALSO DIRECTLY IN CONFLICT WITH DECISIONS OF THE TAX COURT, INCLUDING *LODA POULTRY CO. V. COMMISSIONER*, 88 T.C. 816 (1987) AND WITH A POSITION TAKEN BY THE COMMISSIONER IN *GIANNINI PACKING CORP. V. COMMISSIONER*, 83 T.C. 526 (1983).

The Court of Appeals admitted that its decision is in conflict with a decision of the United States Court of Appeals for the Eleventh Circuit when it stated that it declined to follow that Court's decision in *Munford, supra.* (App. 10) In *Munford, supra,* on similar facts, the Court of

Appeals for the Eleventh Circuit affirmed the Tax Court in its finding that the refrigerated structure involved was not a building under the functional test, stating that the principal purpose or function of the refrigerated area is not to furnish working space for employees, but to provide an area in which frozen foods may be stored at low temperature, and that the employees' activities are merely supportive of and ancillary to that principal purpose or function. (849 F.2d 1398, 1403) The Court of Appeals in *Munford, supra,* determined that the Tax Court's finding of fact in this regard was not clearly erroneous and therefore not reversible. (849 F.2d 1398, 1404)

In this case, the Tax Court determined that the structures in question did not function as working space for employees and equipment, but instead functioned to freeze meat and to provide low temperature storage for meat and other food products, and that the refrigerated structures performed the function, not the employees. (App. 37 and 47) The foregoing Tax Court finding as to the function of the refrigerated structures is substantially identical to that found by the Tax Court in *Munford, supra,* except that in this case, in addition to frozen storage, meat is actually frozen, while in *Munford, supra,* there was only frozen storage. The procedural treatment, on appeal, of these similar Tax Court findings is to be distinguished, however. In *Munford,* the Court of Appeals found the Tax Court was not clearly in error in determining the function of the refrigerated structure. In this case the Court of Appeals reversed the Tax Court *without* determining that the Tax Court was clearly in error, merely determining that it disagreed with the Tax Court, and making its own *de novo* determination of the "function" of the subject refrigerated structures.

The Court of Appeals below wrongly made findings in reference to the "structure," looking at the "structure" or air chamber alone and not as an integrated complete unit, i.e., a "refrigerated structure." Properly it should have considered the complete "refrigerated structure," i.e., the air chamber and the refrigeration equipment combined as one functioning unit. One can no more have a "refrigerated structure" without the operating refrigeration equipment than one can have a "motor vehicle" without a motor, or a brick kiln[2] without a burner to provide heat.

The decision of the Court of Appeals below is also in conflict with the Tax Court's decision in *Loda Poultry, supra,* a case in which three compartments of the taxpayer's refrigerated structure were used to store products at low temperatures, or as frozen products. These compartments were maintained at temperatures varying from 32° F. to 0° F. These compartments were found to be "not a building." (88 T.C. 816, 827) Except for the fact that these three compartments were not used to actually freeze meat, they functioned in a manner comparable to the Petitioners' refrigerated structures.

The decision of the Court of Appeals below is also in conflict with a position taken by the Commissioner in *Giannini Packing Corp., supra,* which the Court of Appeals stated had "no relevant distinguishing factors" from this

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[2] See Treas. Reg. § 1.48-1(e)(l) as to this final example, the brick kiln, which is an approved structure classified as not being within the meaning of the term "building." Brick kilns generate and enclose heat, rather than cold, in the course of the production of bricks.

case, as to the "processing" issue. (App. 20) That case involved a structure which used the same refrigeration principle and performed substantially identical functions as those of the Petitioners herein, with fresh fruit, not meat, as the foodstuff being processed, and with the internal operating temperature being near 32° F. instead of well below freezing. However, in *Giannini, supra,* the parties had agreed that the structure in question was not a building. It can thus be seen that the Commissioner agreed to a position in *Giannini, supra,* on the factual question as to whether or not the structure was a "building," which is exactly opposite from the position of the Commissioner in this case.

To resolve these conflicts, this Court should grant certiorari to review the judgment below.

2. IN FAILING TO APPLY THE "CLEARLY ERRONEOUS" TEST REQUIRED BY F.R.C.P. 52(a), THE COURT OF APPEALS, IN REVERSING THE TAX COURT ON THE "FUNCTION" ISSUE, HAS SO FAR DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS AS TO CALL FOR AN EXERCISE OF THIS COURT'S POWER OF SUPERVISION.

Should this Court determine that the Court of Appeals has improperly failed to use the "clearly erroneous" test under F.R.C.P. 52(a), in reversing the Tax Court's finding of fact on the question of how the Petitioners' refrigerated structures "function," then this Court may, under its Rule 23.1, grant this Petition for Writ of Certiorari and also summarily dispose of this case on its merits, partially reversing the Court of Appeals as to its finding, and holding, that the Petitioners' structures

function as buildings. This would leave standing the Tax Court's finding that these refrigerated structures function to freeze meat (and to provide for frozen storage), that they therefore do not function as buildings, and that they are not buildings. It would also leave standing the determination by the Court of Appeals that the "freezing of meat" is the "processing of meat," therefore "production." It would then follow that these refrigerated structures are "other tangible property (other than a building and its structural components)" which are "used as an integral part of production," and are therefore "section 38 property."

In reviewing decisions appealed from the Tax Court, Courts of Appeal are bound by the following:

(a) Findings of fact shall not be set aside unless clearly erroneous. F.R.C.P. 52(a)

(b) Where there are two permissible views of the evidence, the fact finder's choice between them cannot be clearly erroneous. *Anderson v. City of Bessemer City, North Carolina*, 470 U.S. 564, 574 (1985).

Using the same evidence, the Tax Court and the Court of Appeals have arrived at exactly opposite findings of fact on the question of the "function" of Petitioners' refrigerated structures, resulting in exactly opposite findings on the issue of whether or not these structures are or are not buildings.

The Tax Court's view of the evidence on the question of "function" is clearly permissible, even if another court might find differently when presented with the same evidence, including testimony from a number of expert

and lay witnesses and dozens of documents. The Court of Appeals for the Eleventh Circuit, agreeing with the Tax Court below, reached a similar conclusion as to the "function" of a similar facility in *Munford, supra*. The Tax Court did likewise in *Loda Poultry, supra*. Also, the Commissioner and the taxpayer in *Giannini, supra*, agreed on the "function" and "nonbuilding" issue with respect to the structures involved in that case.

It appears, then, that in this case there are two permissible views of the evidence, the view of the Tax Court that these refrigerated structures *are not buildings*, because they *do not function as buildings* and the view of the Court of Appeals that these same structures *are buildings*, because they *do function as buildings*.

Because there are two permissible views of the evidence, the choice between them, made by the Tax Court as fact finder, cannot be clearly erroneous under the rule established by this Court in *Anderson, supra*. (470 U.S. 564, 574)

Therefore, the Tax Court's finding of fact as to the "function" of these refrigerated structures, and its ultimate finding that they "are not buildings," cannot be clearly erroneous, and cannot be set aside. Any action by the Court of Appeals doing so is in violation of F.R.C.P. 52(a), is contrary to the rule of *Anderson, supra*, and is such a distant departure from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision.

Accordingly, this Court should grant certiorari to review the judgment below.

3. FOR UNIFORM INTERPRETATION AND APPLICATION OF FEDERAL TAX LAWS AS THEY PERTAIN TO THE INVESTMENT TAX CREDIT AND TO THE DEPRECIATION OF REFRIGERATED STRUCTURES SUCH AS THOSE HERE INVOLVED, THE QUESTION OF WHETHER SUCH STRUCTURES ARE, OR ARE NOT, BUILDINGS MUST BE RESOLVED.

Only the Commissioner can enlighten this Court as to how many taxpayers are currently involved in tax disputes similar to those in this case, which are not yet determined by a court. This Court may take judicial notice, however, of the existence of the commercial refrigeration and storage industry in the United States, consisting of a substantial number of taxpayers who are owners and operators of refrigerated structures similar to those here involved, which are used either for the freezing of meat, or for frozen storage of meat and other products, or for both purposes. The record below demonstrates that these structures are built at great cost. For the commercial refrigeration and storage industry, it seems apparent that there are tax years still open which involve both the investment tax credit issue and the depreciation issue. This Court has previously granted certiorari to address questions under repealed tax laws where the questions presented were "of substantial importance in the administration of the income tax laws for earlier taxable years." *Colony, Inc. v. Commissioner,* 357 U.S. 28, 32 (1958).

In addition, for years both before and after repeal of the investment tax credit provisions of the Internal Revenue Code, the depreciation issue, as to both useful life (recovery period) and method of depreciation, is still of great importance to Petitioners and others.

The record below shows that subsequent to the tax years here involved, due to expansion of older facilities, as well as development of new locations, the Petitioners have continued to construct, and are still constructing, refrigerated structures of the type here involved. The question of whether such structures are, or are not, "buildings" is material in determining not only the investment tax credit, but also in determining, both for now and for the future, the proper method of depreciation and the useful life of such structures.

Under current law if such structures are "buildings" then they would seem to be "non-residential real property". See 26 U.S.C. § 168(e)(2)(B). As such they must be depreciated by the straight line method under 26 U.S.C. § 168(b)(3)(A) and their useful life (recovery period) must be 31.5 years under 26 U.S.C. § 168(c).

However, if they are "not buildings," then under the decision in *Munford, supra,* a taxpayer within the jurisdiction of the 11th Circuit, having constructed a refrigerated structure substantially identical to those involved in this case, would presumably depreciate his facility using either the 200% or 150% declining balance method with a useful life (recovery period) possibly as short as 7 years.

Unless this Court settles the question of whether such refrigerated structures are, or are not, "buildings" under the Internal Revenue Code, taxpayers within jurisdictions other than the 8th Circuit and the 11th Circuit will remain in a quandary as to how they should depreciate similar refrigerated structures. Presumably, such taxpayers would logically prefer to follow *Munford, supra,* so as to accelerate the depreciation of their structures for

income tax purposes. However, because of the differences between the decision in *Munford, supra,* and the decision of the Court of Appeals below on the "building" issue, taxpayers such as the Petitioners herein, with refrigerated structures of this type, who are within the jurisdiction of the Eighth Circuit Court of Appeals, will be at great economic disadvantage as compared to taxpayers outside of that jurisdiction. The latter taxpayers, treating their structures "not as buildings," will be able to reduce their taxable incomes by depreciation expenses determined on their structures through the use of the 200% or 150% declining balance method of depreciation with possibly as short as a 7 year useful life, as opposed to the use of the straight line method of depreciation with a 31.5 year useful life.

This non-uniform application of the federal tax law, granting a competitive advantage to some in the refrigeration industry while denying it to others, justifies grant of certiorari.

CONCLUSION

For the foregoing reasons, a Writ of Certiorari should be granted.

Respectfully submitted,

L & B CORPORATION, et al.
Petitioners

PAUL A. RAUTH
MARKS & CLARE
American Charter Center
1623 Farnam Street, Suite 900
Omaha, Nebraska 68102
(402) 422-0900

Attorney for Petitioners

APPENDIX A

L & B CORPORATION, a Nebraska corporation, Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE, Appellee.

Larry A. LARSEN and Betty J. Larsen, Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE, Appellee.

ESTATE OF Howard C. LARSEN, Deceased, Maxine J. Larsen, Executrix and Maxine J. Larsen, Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE, Appellee.

No. 87-2387.

United States Court of Appeals, Eighth Circuit.

Submitted June 16, 1988.

Decided Nov. 25, 1988.

Partnership which sought an investment tax credit for refrigerated structures and associated paved truck turnaround areas and railroad tracks appealed a decision of the United States Tax Court, Mary Ann Cohen, J., 88 T.C. 744, which denied any tax credit. The Court of

Appeals, Heaney, Circuit Judge, held that: (1) the refrigerated structures were "buildings," within the meaning of the Internal Revenue Code, and thus owner was not entitled to credit for the structures, but (2) the blast freezing of meat constitutes processing of meat and the turnarounds and railroad tracks constituted property "used directly in the activity" of blast freezing meat, so as to be entitled to credit.

Reversed.

Paul A. Rauth, Omaha, Neb., for appellant.

Thomas R. Lamons, Dept. of Justice, Washington, D.C., for appellee.

Before HEANEY and MAGILL, Circuit Judges, and LARSON,* Senior District Judge.

HEANEY, Circuit Judge.

L & B Corporation, Larry A. Larsen, Betty Larsen, the estate of Howard Larsen, Maxine J. Larsen, Lance Sterling Larsen and Ashley Larsen, partners in the partnerships of Larsen Realty, Millard Warehouse – Des Moines (Millard-DM), and Millard Warehouse – Denison (Millard-D), appeal a decision of the tax court denying investment tax credits for refrigerated structures and associated paved truck turnaround areas and railroad tracks.

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*The HONORABLE EARL R. LARSON, United States Senior District Judge for the District of Minnesota, sitting by designation.

The individual partners claimed investment tax credits in 1979 and 1980 pursuant to U.S. Internal Revenue Code, 26 U.S.C. § 38, for the cost of constructing these facilities. The Commissioner of Internal Revenue originally allowed a credit for the refrigeration equipment used in the structures and the railroad trackage but disallowed a credit for the cost of constructing the structures themselves.[1] The Commissioner also disallowed a credit for the truck turnaround areas which had subsequently been added to the facilities. On appeal, the Tax Court held that the refrigerated structures, the truck turnarounds, or the railroad tracks were not "buildings" within the meaning of the Internal Revenue Code. The Tax Court denied any tax credit, however, as it found that none of the property was used in manufacturing, production or extraction, as required under the Code.[2]

The partners argue on appeal that an investment tax credit should be given for the cost of the refrigerated structures, truck turnarounds and railroad tracks because they are all used in the process of rapidly freezing meat, an act which constitutes the processing of meat within the meaning of the Internal Revenue Code. The Commissioner argues that freezing does not constitute the "processing of meat" because it improves neither the quality

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[1] The investment tax credit given for the cost of the refrigeration equipment is not an issue on appeal. *See* Tax Court Opinion, at 16; Appellee's Brief, at 12.

[2] The Tax Court's opinion, which includes a detailed statement of the facts of this case, is reported at 88 T.C. 744 (1987) [available on WESTLAW, 1987 WL49298].

nor the marketability of the product. Furthermore, the Commissioner challenges the Tax Court's determination that the structures are not "buildings" within the meaning of the Code and Treasury Regulations.

We reverse the Tax Court's holding that the refrigerated structures are not buildings within the meaning of the Internal Revenue Code. We also reverse the Tax Court's holding that the rapid freezing of meat is not the "processing of meat." We hold that the partners may not claim a tax credit for the structures but may claim a credit for the truck turnaround areas and those railroad tracks used to transport meat to the structures.

I. FACTUAL BACKGROUND

The partners claimed investment tax credits for the cost of constructing or improving several refrigerated structures located in Omaha, Nebraska; Lincoln, Nebraska; Des Moines, Iowa; and Denison, Iowa. The refrigerated structures are all constructed in a similar manner. They rest on a foundation of poured concrete and concrete block footings. The floors of the structures are 6-inch poured concrete slabs. Beneath the concrete floor is a 6-inch layer of polystyrene insulation, which serves to maintain cold temperatures inside the structures. Beneath the insulation and extending under the loading dock is a layer of gravel. Clay pipes within the gravel layer serve to remove waste heat from compressors inside the structures, preventing the ground below the floor from freezing, buckling or heaving.

The walls are made of steel and concrete blocks. The roof is made of corrugated steel and is covered with nine

inches of insulation. A single-ply membrane roof covers the insulation.

The partners installed storage racks, refrigeration coils and blowers inside the refrigerated structures. The racks are bolted to the concrete floor, and the coils and blowers are attached to the ceiling above the racks. The storage racks are designed to facilitate the circulation of air over and around the meat stored on the racks. The racks are removable, but holes where the bolts entered the concrete floor would have to be plugged. The lighting systems in these facilities are especially adaptable to extremely low temperatures. An elaborate sprinkler system has been designed to prevent water from freezing in the pipes. The refrigeration equipment, including the coils and blowers, could be removed without structural damage.

Local meat packers, such as Swift, Iowa Beef Packers, and Farmland Foods, ship large quantities of fresh meat to these refrigerated structures. The meat, usually boxed or packaged with labels or brand names, is unloaded at the rail and truck docks adjacent to the structures, placed on pallets, and taken into special compartments inside the structures, called blast freezers, to be rapidly frozen. When this process is finished, the meat is stored in the other refrigerated compartments until shipped back to the packers or to third party purchasers by truck or rail. The rail facilities at Millard-D and Millard-DM accommodated the partnership's export business. The railroad tracks at Millard-DM were used for both in-shipments and out-shipments. Those tracks at Millard-D were used almost exclusively for out-shipments.

During 1979 and 1980, the facilities handled as much as 20 million pounds of meat per week. Although the

facilities received some pre-frozen meat, an estimated 99% of all meat received went through the blast freezing process.

II. LEGAL DISCUSSION

The sole issue on appeal is whether, under section 38 and section 48(a)(1)(B) of the Internal Revenue Code[3] the

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[3] Section 38, in effect during the pertinent period, provided:

> (a) *General Rule.* – There shall be allowed, as a credit against the tax imposed by this chapter, the amount determined under subpart B of this part.
>
> (b) *Regulations.* – The Secretary shall prescribe such regulations as may be necessary to carry out the purpose of this section and subpart B.

Internal Revenue Code of 1954, 26 U.S.C. § 38 [as added by Sec. 2(a), Revenue Act of 1962, Pub.L. No. 87-834, 76 Stat. 960].

Section 48, in effect during the pertinent period, provided:

> (a) *Section 38 property.* –
>
> (1)*In general.* – Except as provided in this subsection, the term "section 38 property" means –
>
> (A) tangible personal property (other than an air conditioner or heating unit), or
>
> (B) *other tangible property (not including a building and its structural components) but only if such property* –
>
> (i) *is used as an integral part of manufacturing, production,* or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services,* * *

Internal Revenue Code of 1954, 2 U.S.C. § 48(a)(1)(A)-(B)(i) [as added by Sec. 2(a), Revenue Act of 1962, Pub. L. No. 87-834, 76 Stat. 960] (emphasis added).

refrigerated structures, the truck turnarounds and the railroad tracks are "other tangible property," other than buildings, used as an integral part of manufacturing or production.[4] The issues before this Court are whether the refrigerated structures constitute buildings and whether any of the property is being used in manufacturing or production.

A. The Refrigerated Structures

Section 48 of the Internal Revenue Code authorized a tax credit for tangible property, excluding buildings, used

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[4] The investment credit provisions of the Internal Revenue Code, effective in 1979 and 1980, allowed a tax credit for investments in certain types of depreciable property. These credits were enacted in 1962 to create tax incentives to purchase new equipment. Congress hoped to improve our competitive position abroad and to stimulate the economy by encouraging the modernization and expanded use of capital equipment and machinery. *Yellow Freight System, Inc. v. United States*, 538 F.2d 790, 794 (8th Cir.1976); *Illinois Cereal Mills, Inc. v. Commissioner*, 789 F.2d 1234, 1236 (7th Cir.), *cert. denied*, 479 U.S. 995, 107 S.Ct. 600, 93 L.Ed.2d 600 (1986). The purpose of the investment tax credit was to encourage investment in machinery and equipment. H.R.Rep. No. 1447, 87th Cong., 2d Sess. (1962-3 Cum.Bull. 405, 413). Most tangible personal property qualified for a tax credit under section 48(a)(1)(A). *Id.* Congress also allowed investment credits for improvements to real property in section 48(a)(1)(B) if the real property was used as an integral part manufacturing or production. H.R.Rep. No. 1447, *supra* (1962-3 Cum.Bull. at 413, 415); S.Rep. No. 1881, 87th Cong., 2d Sess. (1962-3 Cum.Bull. at 720, 722), U.S. Code Cong. & Admin.News 1962, p. 3297. Buildings and structural components of buildings were expressly excluded from this provision. H.R.Rep. No. 1447, *supra* (1962-3 Cum.Bull. at 415); S.Rep. No. 1881, *supra* (1962-3 Cum.Bull at 722).

in manufacturing industries. Although the Code does not define what constitutes a "building," the Treasury Regulations restate major portions of legislative history and give some indication of what types of structures Congress intended to exclude from the tax credit provision.

Section 1.48-1(e)(1) of the Treasury Regulations defines a building and its structural components as:

> * * * any structure or edifice enclosing a space within it walls, and usually covered by a roof, the purposes of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, *warehouses*, barns, garages, railway or bus stations, and stores.

26 C.F.R. § 1.48-1(e)(1) (emphasis added).

The regulation and the relevant legislative history define a "building" in terms of physical appearance and function. *Yellow Freight System, Inc. v. United States*, 538 F.2d 790, 796 (8th Cir.1976). The test that this Court and others have used to categorize structures is: 1) whether the structures resemble buildings; and 2) whether they function as buildings.

1. *Resemblance*

The Tax Court held, and this Court concurs, that the structures look like buildings. Tax Court Opinion, at 23. "The structures are permanent structures of substantial dimensions which enclose spaces surrounded by walls and covered by roofs." *Id.*

2. *Function*

We disagree, however, with the Tax Court's conclusion with respect to the second question. We believe that the refrigerated structures do function as buildings for several reasons.

First, Congress and the Treasury Regulations specifically list a warehouse as a building. 26 C.F.R. § 1.48-1(e); H.R.Rep. No. 1447, *supra* (1962-3 Cum.Bull. at 516); S.Rep. No. 1881, *supra* (1962-3 Cum.Bull. at 859).

Second, the Tax Court applied an unduly restrictive version of the function test in this case. Following *Munford, Inc. v. Commissioner*, 87 T.C. 463 (1986) [available on WESTLAW, 1986 WL 22010] *aff'd* 849 F.2d 1398 (11th Cir.1988),[5] the Tax Court held that the structures in the present case are not "buildings" because they do not primarily provide working space for humans. Tax Court Opinion, at 25. We believe that this holding ignores the full definition in Treas.Reg. § 1.48-1(e)(1), which specifically includes structures that provide shelter, housing, working space, office space, parking, display areas, or sales space within the definition of "buildings." Nothing, either in the Code or in the Regulations, implies that this space must be primarily occupied by humans to qualify as a building.

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[5] In *Munford*, a taxpayer sought an investment tax credit for refrigerated warehouses in which he stored prepackaged and prefrozen foods. Both the Tax Court and the Eleventh Circuit denied a tax credit because the warehouses did not provide working space for humans which was more than incidental to the main purpose of the structure to store frozen goods. *Munford*, 849 F.2d at 1404.

Moreover, the Tax Court's test contradicts Congress' instruction that the term "building" be given its commonly accepted meaning. H.R.Rep. No. 1447, *supra* (1962-3 Cum.Bull. at 516); S.Rep. No. 1881, *supra* (1962-3 Cum.Bull. at 859). In *Munford*, the Eleventh Circuit acknowledged that the Tax Court has formulated a narrower definition of "building" than was intended by Congress. That court stated:

> In reviewing this determination, we begin with the premise that "in the investment tax credit context, the term 'building' has become a term of art," notwithstanding Congress' original intent that the term be accorded its commonly accepted meaning.

Munford, 849 F.2d at 1403, *citing Munford*, 87 T.C. at 478. Thus, the Tax Court's definition nullifies Congress' intent. We decline to follow *Munford's* acquiescence in this reading of the Treasury Regulations.[6]

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[6] The Tax Court's departure from the original intent of Congress stems from its interpretation of *Yellow Freight System, Inc. v. United States*, 538 F.2d 790 (8th Cir.1976). In *Yellow Freight*, this Court held that docks and inspection lanes constructed by a freight carrier constituted "buildings" within the meaning of section 48(a)(1)(B). The loading docks and inspection lanes were permanent structures used to expedite freight and to inspect the long-haul vehicles. In a footnote to its discussion of the "function" test, this court stated:

> We consider the amount of human activity which occurs within the structure an important consideration under § 48(a)(1)(B) since "buildings," according to Treas.Reg. § 1.48-1(e)(1), typically provide work space for such human activity. The quantum of employee activity is, in our opinion, critical in determining whether the function of a given structure is principally, or only incidentally, to provide work space.

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We prefer the analysis of *Starr Farms, Inc. v. United States*, 447 F.Supp. 580 (W.D.Ark.1977), in which the District Court of Arkansas refused to follow the Tax Court's narrow description of "building." In *Starr Farms*, the taxpayer claimed an investment credit for construction of several environmentally controlled chicken coops. The court held that the coops were buildings within the meaning of Treas.Reg. § 1.48-1(e)(i), even though the coops did not primarily provide humans with working space. The district court argued quite persuasively:

> [A] structure will be deemed to function as a building even if the activity which it shelters is performed solely by machine or animal. To hold otherwise would mean that all structures housing only machines would automatically be deemed non-buildings under the functional test.

Starr Farms, 447 F.Supp. at 583.

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Yellow Freight, 538 F.2d at 797 n. 11 (citations omitted).

Footnote 11, discussing the amount of human activity carried on, was in response to a case in which the Ninth Circuit held that the nature of human activity was relevant to the definition of "building," but the amount of human activity was not. *See Thirup v. Commissioner*, 508 F.2d 915, 919 (9th Cir.1974), *rev'g* 59 T.C. 122 (1972) [available on WESTLAW, 1972 WL 2565].

Although this footnote may lend some support to the Tax Court's application of the function test, the holding of *Yellow Freight* does not. In *Yellow Freight*, this Court held that the loading docks and inspection lanes constituted "buildings" because the property provided "shelter and work space so that the men and equipment can perform their functions." *Id.* at 796. This Court did not hold that only structures providing working space for humans constitute "buildings."

We believe that the functional test in *Starr Farms* is closer to congressional intent and provides a more enduring analytical framework for this question. Thus a structure functions as a "building" it it provides shelter for significant machine or animal activity or if it provides working space for humans.[7]

Under this broader concept of "function," the refrigerated structures constitute "buildings." Although employee activity is limited to unloading, palletizing, and moving meat from one storage area to another, significant machine activity is conducted inside the structures by the blast freezers. The refrigerated structures provide shelter for the refrigeration equipment and provide working space for the employees so that meat can be rapidly frozen, stored and shipped. Applying the test above, we find that these structures function as "buildings." Our holding is consistent with Congress' intent that the term "building" be given its commonly accepted meaning, with the "function" test used by this Court in *Yellow Freight*, and with the district court's approach in *Starr Farms*.[8]

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[7] This test does not include highly specialized structures which actually perform the activity. These structures would qualify as exceptions under Treas.Reg. § 1.48-1(c)(1)(i) or (ii). *See*, Section I A 3, *infra*.

[8] This court acknowledges that it departs from the narrow definition of "building" used by the Tax Court and several other circuits. *See, e.g., Munford, supra; Brown and Williamson Tobacco Corp. v. United States*, 369 F.Supp. 1283 (W.D.Ky.1973), *aff'd percuriam*, 491 F.2d 1258 (6th Cir.1974) (tobacco drying

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We also recognize that several courts have applied the narrower function test to determine whether refrigerated structures constitute "buildings." *See Brown-Forman Distillers Corp. v. United States*, 499 F.2d 1263, 1272, 205 Ct.Cl. 402 (1974) (whiskey maturation facilities constitute "storage facilities" and not "buildings"), *Merchants Refrigerating Co. v. Commissioner*, 60 T.C. 856 (1973) [available on WESTLAW, 1973 WL 2607] (a large freezer room used for storing frozen foods was not a building but a storage facility under section 48(a)(1)(B)(ii) as then in effect); and *Central Citrus Company v. Commissioner*, 58 T.C. 365, 371 (1972) [available on WESTLAW, 1972 WL 2547] (atmospherically controlled "sweet rooms" used to ripen fruit were not buildings but storage facilities under section 48(a)(1)(B)(ii) as then in effect); *Catron v. Commissioner*, 50 T.C. 306 (1968) [available on WESTLAW, 1968 WL 1547] (the refrigerated area of a Quonset-type structure used for the cold storage of apples qualified for the tax credit as a "storage facility" under section 48(a)(1)(B)(ii) as then in effect).

At the time these cases were decided, however, the Internal Revenue Code allowed a tax credit for all storage facilities used in connection with a qualifying activity. Thus, the distinction drawn between structures merely housing goods or equipment and structures providing

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sheds used solely for storage are not buildings); *Thirup v. Commissioner, supra,* (a greenhouse does not function as a building). The Internal Revenue Service, as well, has been unwilling to follow the limited approach taken by these cases. *See* Rev. ruling 77-363 (1977-2 Cum.Bull. 10), *modified by* Rev.Ruling 79-343 (1979-2 Cum.Bull. 18) (Internal Revenue Service refuses to follow *Thirup* decision).

working space for humans was used to distinguish storage facilities from buildings. The provision has since been limited to cover only facilities used to store fungible commodities.[9] The Tax Court decided that the structures in this case do not constitute such a storage facility because the meats were not fungible commodities. Tax Court Opinion, at 34. We agree with the Tax Court's assessment and note that because these refrigerated structures do not qualify as a storage facility under section 48(a)(1)(B)(ii), they must be "buildings" within the meaning of section 48(a)(1)(B).

3. *Exceptions Under Treas.Reg. § 1.48-1(c)(1)(i) and (ii).*

Lastly, the partners argued in oral argument that the structures are not buildings because they fall into the exceptions of Treas.Reg. § 1.48-1(e)(1)(i) and (ii).[10] They

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[9] Congress amended section 48(a)(1)(B)(ii) by section 102(a)(2) and 104(a)(1) of the Revenue Act of 1971, Pub.L. No. 92-178, 85 Stat. 497, replacing the term "storage facility" with the narrower concept of a "facility used * * * for the bulk storage of fungible commodities." 26 U.S.C. § 48(a)(1)(B)(ii).

[10] Section 1.48-1(e)(1)(i) provides that the term "building" does not include structures which are essentially an item of equipment. Section 1.48-1(e)(1)(ii) excludes any structure:

> which houses property used as an integral part of any activity specified in section 48(a)(1)(B)(i) if the use of the structure is so closely related to the use of such property that the structure clearly can be expected to be replaced when the property it initially houses is replaced.

Treas.Reg. § 1.48-1(e)(1)(ii).

The regulation cites to structures such as oil and gas storage tanks, grain storage bins, silos, fractioning towers, blast furnaces, coke ovens and coal tipples as examples. *Id.*

argued that the warehouse structures served as "giant refrigerators," without which the refrigeration equipment would be unable to function. The Tax Court acknowledged the parties' arguments on this point but refused to reach the issue in light of its decision that the warehouses did not function as buildings. Tax Court Opinion, at 27, n. 4. Because we reverse this decision, we must address the issue of whether the structures qualify for either exception.

Under section 1.48-1(e)(1)(i), a structure warrants a tax credit if it actually functions as a piece of equipment. After reviewing the record, we find that the structures in this case do not perform the function of freezing the meat. Rather, they were designed to withstand the cold temperatures produced by the compressor engines, the refrigeration coils, and the blowers. The insulation helped maintain the conditions in the structure; the structure itself did not create those conditions. Based on these facts, it appears that the structures are sufficiently separate from the equipment that it cannot fairly be said that the structures perform the function.

Under section 1.48-1(e)(1)(ii), the appropriate factors to consider are whether the structure is specially designed to meet the demands of the refrigeration equipment, and whether the structure could be economically used for other purposes.

The structures were designed and constructed in such a manner "as to provide for the cold storage of certain meats and other products." Tax Court Opinion, at 6. The walls, floor and ceiling were insulated. Clay pipes had been laid under the cement floor through which hot

air was pumped to keep the floors from freezing, buckling or heaving. Special lighting systems and sprinkler systems which would adapt to the extremely cold temperatures had been installed. Thus, the structures appear to have been designed to meet the demands of the blast freezing process.

Expert testimony indicates, however, that these structures are easily converted from blast freezers to either cold storage facilities or conventional dry storage space without any modifications. Engineering Report of Michael A. Gregory, Exh. AR at 11; Exh. AS at 9. An expert for the partners conceded at trial that the freezer structures could be used for dry storage. Doc. 45 at 144, 256. To convert the structures to other uses, one might replace the lighting system and remove the refrigeration equipment, but neither is necessary to convert the structures to conventional warehouses. *Id.*, at 252-53. Even if the storage racks and the refrigeration equipment had to be removed, it could be done without causing any structural damage.[11] Tax Court Opinion, at 12-13. Because these structures could be used for either cold storage or dry storage without any modifications, we find that they do not fit the exception of section 1.48(a)(1)(B)(ii).

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[11] We understand that these structures have some special features, such as the clay pipes, the lighting system, and the sprinklers, which would not be found in a conventional warehouse. Yet, none of these features appears to impede the use of the freezers as warehouses. The partners' expert witness conceded that the structures were "over designed" to be conventional warehouses, but that they were conducive to dry storage. Doc. 45 at 244-256.

B. Other Property

Although the partners may not claim an investment tax credit for the warehouse structures, they may offset the cost of the truck turnaround areas and railroad trackage if this property qualifies as "other tangible property" used as an integral part of a qualifying activity. Thus, we must address whether the blast freezing of meat constitutes "manufacturing, production, and extraction," and whether the truck turnarounds and railroad tracks are used as an integral part of the activity pursuant to section 48(a)(1)(B)(i).

1. *Manufacturing, Production, and Extraction*

The Tax Court held that no investment tax credit should be allowed for the structures, the truck turnarounds and the railroad trackage because the structures were used primarily for cold storage and the initial freezing function was not necessary for providing a desirable or finished product. Tax Court Opinion, at 31. We disagree.

The Treasury regulations define "production" as follows:

> (2) *Manufacturing, production, and extraction.* For purposes of the credit allowed by section 38, the terms "manufacturing", "production", and "extraction" include the construction, reconstruction, or making of property * * * from new or raw material, by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles, and include the cultivation of soil, the raising of livestock, and the mining of minerals. Thus, section 38 property would include, for

> example, property used as an integral part of * * * *the processing of meat,* fish, or other foodstuffs * * *.

Treas.Reg. § 1.48-1(d)(2) (emphasis added).

The Tax Court clearly erred in finding that the property was not used as an integral part of processing meat.[12] First, the Tax Court heard the expert testimony of Dr. Robert E. Rust, Professor in the Department of Animal Science at Iowa State University, who testified in his report that "freeezing or chilling to a specific temperature constitutes a process just as would canning or sterilizing." Exhibit AQ, at 1. Dr. R. Paul Singh, Professor of Food Engineering at the University of California-Davis, testified that blast freezing, as conducted in the partnership's warehouses, constituted the processing of meat because the freezing prevented spoilage of the meat. Exhibit 44 at 1. Dr. Daryl Lung, Professor of food science at the University of Wisconsin-Madison, defined food processing as "the application of chemical, microbiological, and engineering principles to food products for the purpose of improving the value of the product to the consumer." Exhibit 45 at 1. It appears quite clear from the statements of these three experts that the freezing of meat

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[12] This issue involves an analysis of fact and law, as the term "processing of meat" may have one meaning within the food processing industry but another meaning in the Internal Revenue Code. In mixed law-fact questions involving the interpretations of the Internal Revenue Code, the Court will only reverse if the lower court's finding is clearly erroneous. *Merchants Refrigerating Co. v. United States,* 659 F.2d 116, 117 (9th Cir.1981), *cert. denied,* 456 U.S. 973, 102 S.Ct. 2236, 72 L.Ed.2d 846 (1982) (clearly erroneous standard applied to question of what constitutes a facility used for bulk storage of fungible commodities).

is considered by the food science industry as a part of the overall processing scheme.

Other tax cases support the partners' position that the blast freezing of meat constitutes the processing of meat within the meaning of the Treasury Regulations. In *Giannini Packing Corp. v. Commissioner,* 83 T.C. 526, 533-34 (1984) [available on WESTLAW, 1984 WL 15615], the Tax Court held that two cooler rooms used to lower the temperature of apples qualified for an investment tax credit because they prevented the apples from dehydrating and shriveling. This process was found necessary to prepare the fruit for shipment. *Id.* at 534. Similarly, in *Central Citrus Co. v. Commissioner,* 58 T.C. 365, 371 (1972), the Tax Court allowed an investment tax credit for "sweet rooms" in which fruit was degreened through the controlling of atmospheric conditions.[13]

The Tax Court attempts to distinguish these cases by stating that in *Giannini* and *Central Citrus,* the atmospheric conditions changed the food product into a desirable or finished product. Tax Court Opinion, at 31. It implied that blast freezing meat did not enhance the meat product in any way. *Id.* The Tax Court, however, neglected to acknowledge that only through freezing or

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[13] *See also, Brown-Forman Distillers Corp. v. United States,* 499 F.2d 1263, 1272-3, 205 Ct.Cl. 402 (1974) (maturation of whiskey constitutes a process because it aged whiskey); and *Schuyler Grain Co. v. Commissioner,* 50 T.C. 265, 272 (1968) [available on WESTLAW, 1968 WL 1543] *aff'd* 411 F.2d 649 (7th Cir.1969) (aeration and drying of grain is a process because it improves the quality of grain for its intended use).

other similar preserving processes can fresh meat products arrive at their final destination in an edible condition. Like the process used in *Giannini*, the process of blast freezing is necessary to prepare the meat for shipment. We believe that the blast freezing rendered a change in the meat which was necessary to providing consumers with an edible product. We see no relevant distinguishing factors between *Giannini* and this case.

Even more disturbing is the apparent conflict between this case and *Loda Poultry Co. v. Commissioner*, 88 T.C. 816 (1987) [available on WESTLAW, 1987 WL 49301], in which the Tax Court held that a 32-degree compartment used to store chickens to prevent spoilage before the meat was sold and shipped qualified for an investment tax credit because it was used as an integral part of a chicken processing business. The only distinction between the storage of meat in the *Loda* case and in the present case is that the chicken had been cut, cleaned, inspected, packaged, and then stored on the same premises. This distinction hardly warrants the legal significance attributed to it by the Tax Court. Thus, blast freezing constitutes the processing of meat and the Tax Court clearly erred in determining otherwise.

2. *Integral Part of Production*

In order for property to qualify for the investment tax credit, it must be used as an integral part of production. Treas. Reg. § 1.48-1(d)(4) includes property which is:

> used directly in the activity and is essential to the completeness of the activity. * * * [A]ll properties used by the taxpayer in acquiring or transporting raw materials or supplies to the point where the actual processing commences (such as docks, railroad tracks, and bridges), or in processing raw materials

> into the taxpayer's final product, would be considered as property used as an integral part of manufacturing. Specific examples of property which normally would be used * * * are * * * railroad tracks and signals * * *.

Treas.Reg. § 1.48-1(d)(4).

The Commissioner concedes that the truck turnarounds and the railroad tracks at the Millard-DM warehouse qualify for the investment tax credit if used as an integral part of the processing of meat. Appellee's Brief, at 23 n. 16. As the turnarounds and railroad tracks were used in transporting fresh meat into the refrigerated structures, they constitute property "used directly in the activity" of blast freezing meat.

III. CONCLUSION

We reverse the Tax Court and hold that the refrigerated structures in this case function as buildings because they are non-specialized structures which provide shelter for significant machine and human activity. We also hold that the blast freezing conducted in the refrigerated structures constitutes the processing of meat. Thus, all of the truck turnarounds and the railroad tracks at Millard-DM qualify for an investment tax credit.

Because the truck turnarounds qualify as other tangible property under section 1.48-1(d) of the Treasury Regulations and Section 48(a)(1)(B)(i) of the Code, they also qualify as "other property" under section 1245(a)(3)(B)(i) of the Code and may be depreciated under the 200% declining balance method of depreciation under section 167(b)(2).

APPENDIX B

United States Court of Appeals
FOR THE EIGHTH CIRCUIT

No. 87-2387

L & B Corporation, a Nebraska corporation, Appellant, v. Commissioner of Internal Revenue Appellee.	*	*JUDGMENT* Appeal from the United States Tax Court.
* * * * * * * Larry A. Larsen and Betty J. Larsen, Appellants, v. Commissioner of Internal Revenue, Appellee.	*	(Filed November 25, 1988)
* * * * * * * Estate of Howard C. Larsen, Deceased, Maxine, J. Larsen, Executrix and Maxine J. Larsen, Appellants, v. Commissioner of Internal Revenue, Appellee.	*	

This appeal from the United States Tax Court was submitted on the record of the tax court, briefs of the parties and was argued by counsel.

After consideration, the Tax Court's order is reversed in accordance with the opinion of this Court.

November 25, 1988

Order entered in accordance with opinion.

/s/ Robert D. St. Vrain
Clerk, U.S. Court of Appeals, Eighth Circuit.

APPENDIX C

United States Court of Appeals
FOR THE EIGHTH CIRCUIT

No. 87-2387

L & B Corporation, etc. Appellant, vs. Commissioner of Internal Revenue Appellee.	*	Appeal from the United States Tax Court

Appellant's petition for rehearing has been considered by the Court and is denied.

January 6, 1989

Order Entered at the Direction of the Court:

/s/ Robert D. St. Vrain
Clerk, U.S. Court of Appeals, Eighth Circuit.

APPENDIX D

L&B CORPORATION, A NEBRASKA CORPORATION, ET AL.[1] PETITIONERS V. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket Nos. 32911-84, 32935-84, 33261-84. Filed April 6, 1987.

Petitioners' partnerships placed in service refrigerated structures, truck turn-arounds, and railroad trackage during the years in issue. Meat packers and other independent parties rented or leased space in the refrigerated structures primarily for the cold storage of various meats and certain other food products. Petitioners sought investment tax credits under sec. 38, I.R.C. of 1954, as amended, with respect to costs relating to the structures. Respondent allowed credits only with respect to certain refrigeration system components of the refrigerated structures. *Held*, the refrigerated structures are not buildings for purposes of the investment tax credit. *Held, further*, the cold storage of meats and other food products, the primary function of the refrigerated structures, is not a "processing of meat" within the meaning of sec. 1.48-1(d)(2), Income Tax Regs., and therefore not an "integral part of * * * production." Sec. 48(a)(1)(B)(i). *Held, further*, the refrigerated structures are not used for the bulk storage of fungible commodities within the meaning of sec. 48(a)(1)(B)(iii). *Held, further*, the costs relating to the refrigerated structures, truck turn-arounds, and railroad trackage are thus eligible for investment tax credit only to the extent allowed by respondent. *Held, further*, the refrigerated structures and truck turn-arounds may be depreciated

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[1] Cases of the following petitioners are consolidated herewith: Larry A. Larsen and Betty J. Larsen, docket No. 32935-84; and Estate of Howard C. Larsen, Deceased, Maxine J. Larsen, Executrix and Maxine J. Larsen, docket No. 33261-84.

under the 150-percent-declining-balance method but not the 200-percent-declining-balance method. *Held, further,* the useful lives of the refrigerated structures and railroad trackage determined.

Truman Claire, Steven M. Watson, Paul A. Rauth and *Jackie L. Vencil,* for the petitioners.

Robert L. Archambault, for the respondent.

COHEN, *Judge*: Respondent determined the following deficiencies in petitioners' Federal income taxes and claimed, by amendments to answer, the following increased deficiencies in petitioners' Federal income taxes:

Petitioner	*Year*	*Deficiency*	*Increased deficiency*
L&B Corp.	2/28/75	$10,353.89	
	2/29/76	307.58	
	2/28/79	18,991.04	
	2/29/80	19,590.06	
	2/28/81	17,249.75	$3,325.91
Larry A. Larsen and	1976	9,301.73	
Betty J. Larsen	1977	22,770.73	
	1978	13,916.15	
	1979	27,177.68	
	1980	20,708.32	4,096.49
Estate of Howard C.	1976	6,803.23	
Larsen, deceased,	1977	1,903.85	
and	1978	11,843.21	
Maxine J. Larsen	1979	29,627.03	
	1980	28,418.35	1,683.14

Petitioners were partners in certain partnerships. After concessions, the issues for decision are (1) whether petitioners are entitled to investment tax credits under

section 38[2] with respect to certain refrigerated structures, truck turn-arounds, and railroad tracks placed in service by the partnerships in 1979 and 1980 to an extent greater than allowed by respondent; (2) whether the partnerships are entitled to depreciation deductions with respect to the refrigerated structures and truck turn-arounds using the 200-percent-declining-balance method of depreciation under section 167(b)(2); and (3) whether the partnerships are entitled to depreciation deductions with respect to the refrigerated structures and railroad tracks based on useful lives of 15 years or 33⅓ years.

FINDINGS OF FACT

Some of the facts have been stipulated. The facts set forth in the stipulations are incorporated in our findings by this reference.

Petitioner L&B Corp., a Nebraska corporation, had its principal place of business in Omaha, Nebraska, when its petition was filed. The corporation filed 1974 through 1980 corporate income tax returns with the Internal Revenue Service Center in Ogden, Utah, for its fiscal years ended February 28, 1975, through February 28, 1981, respectively. Petitioners Larry A. Larsen and Betty J. Larsen, husband and wife, resided in Omaha, Nebraska, when they filed their petition. They filed joint Federal income tax returns for 1976 through 1980 and an amended return for 1978 with the Internal Revenue Service Center in Ogden, Utah. Howard C. Larsen died on

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[2] Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954 as amended and in effect during the years in issue.

June 7, 1982, and his surviving spouse, Maxine J. Larsen, is the duly appointed executrix of his estate. Petitioner Maxine J. Larsen resided in Omaha, Nebraska, when she filed the petition on behalf of her husband's estate and herself. They filed joint Federal income tax returns for 1976 through 1980. They had two chidren, Lance Sterling Larsen and Ashley Larsen.

Petitioners were partners in Larsen Realty, Millard Warehouse - Des Moines (Millard-DM), and Millard Warehouse - Denison (Millard-D) (collectively, the partnerships), partnerships with principal offices located in Omaha, Nebraska. The partnerships filed information returns with the Internal Revenue Service Center in Ogden, Utah, as follows: Larsen Realty for calendar years 1979 and 1980, Millard-DM for calendar years 1979 and 1980, and Millard-D for calendar year 1980.

By partnership agreements, the following partners, including petitioners, were entitled to distributive shares of income, gain, loss, deductions, and credits of said partnerships in the percentages and for the years indicated:

Partners	*Larsen Realty* (1979-80)	*Millard Warehouse–Des Moines* (1979-80)	*Millard Warehouse–Denison* (1980 only)
L&B Corp.		50%	
Larry A. Larsen	50%	25	60%
Howard and Maxine Larsen	50		
Howard Larsen		25	
Lance Sterling Larsen			20
Ashley Larsen	20 (sic)		
	100	100	100 (sic)

Description of the Facilities

Larsen Realty operated its business in facilities located in Omaha, Nebraska (LR-Omaha), and Lincoln, Nebraska (LR-Lincoln). LR-Omaha commenced operations in about 1961, at which time its first cold storage facility was built. On or about August 1, 1979, Larsen Realty placed in service the following additions to LR-Omaha: a refrigerated structure, a loading dock area, and a paved truck turn-around area.

The refrigerated structure, as described below, was designed and constructed in such a manner as to provide for the cold storage of certain meats and other products. Thus, the structure includes certain insulation and other special features to maintain cold temperatures inside the structure and to prevent the penetration of moisture into the facility.

The refrigerated structure is rectangular in shape, approximately 160 feet by 130 feet, and stands approximately 25 feet high. The structure rests on a foundation of poured concrete footings, under each wall and the dock partition, and concrete block footings, under certain walls. The structure and the pre-existing facility share a common wall, an insulated metal panel wall. The floor of the structure is a 6-inch poured concrete level slab. Beneath the concrete floor is a 6-inch layer of polystyrene insulation. Beneath the insulation and extending under the added loading dock area is a layer of gravel. Approximately 40 rows of 4-inch clay pipe run north to south within the gravel layer under the floor of the cold storage facility and dock area. Waste heat from refrigerator compressors is pumped through the clay tiles to the outside

to keep the ground below the floor from freezing which, if it did, would cause the floor of the structure to buckle or heave. Prior to construction, the soil was tested to determine if the water table was sufficiently low so that unnecessary moisture would not be drawn up to the floor of the structure.

Steel wall panels and concrete blocks form the walls of the structure. The panels, approximately 25 feet high and 5 feet wide, are connected by tongue and groove. The panels are 5 inches thick and are constructed of a corrugated metal outer face and a smooth metal inner face which sandwich about 5 inches of polyurethane insulation. The panels are placed and sealed in a track that is glued to the footings around the perimeter of the storage facility. The insides of the panels are bolted to the steel framing, and the tops of the panels are sealed in a track. A concrete bumper, which was poured against the panels on the inside of the exterior walls and anchored to the floor slab, prevents forklifts from backing up into the wall.

The roof of the structure is relatively flat, sloping 1/8 inch per foot. It is supported by steel roof joists that are welded to outside wall beams and certain interior beams. A 1 1/2 inch thick, 22-gauge corrugated steel decking is situated on the roof joists. Nine inch insulation boards lie over the steel decking above the cold storage area, and 4 1/2-inch insulation boards lie over the decking above the added dock area. A single-ply membrane roof cover lies over the insulation.

The equipment attached to the interior of the structure consists of storage racks, refrigeration coils and

blowers (chiller units), and piping from the pre-existing refrigeration compressor room. The storage racks are bolted to the concrete slab floor. The two chiller units are attached above the storage racks close to the west wall and supported from the ceiling and structural I-beams.

The costs of the additions to LR-Omaha were as follows:

Building		*Cost*
Dock area		$39,484.97
Freezer area		
Structure	$337,307.65	
Refrigeration equipment	42,834.81	380,142.46
Non-refrigeration equipment		
Storage racks	53,068.07	
Fork lifts	19,242.54	
Dock levelers	3,969.46	
Other	437.22	76,717.29
Truck turn-around area		17,673.30
Total cost		514,018.02

In 1979, Larsen Realty also made certain improvements to LR-Lincoln. The costs of the additions were as follows:

Property	*Cost*
Addition improvements	$78,551.45
Non-refrigeration equipment	18,863.61
Truck turn-around	14,490.84
	111,905.90

Millard-DM operated its business in facilities located in Des Moines, Iowa. On December 1, 1979, Millard-DM placed in service its main cold storage facility, or refrigerated structure. An addition to this facility was placed in service on March 1, 1980. On or about September 1, 1980, a railroad spur leading up to the addition was placed in

service. The main refrigerated structure and its addition were designed and constructed, in a manner similar to the LR-Omaha facility, to provide for the cold storage of meats and other products.

The main facility is approximately 289 feet by 194 feet and is approximately 25 feet tall. It includes several truck docks, general offices, a mezzanine, a cooler storage area, and a freezer storage area. The cooler storage area is divided by interior walls into four coolers, of which two measure 64 feet by 64 feet and the other two measure 64 feet by 32 feet. The freezer storage area, which is adjacent to the cooler area, is approximately 160 feet by 191 feet and includes two 32-foot by 25-foot areas, with movable wood partitions, that are called blast cells or blast freezers.

The addition placed in service in 1980 is located immediately west of the main facility and includes a railroad dock, a compressor or engine room, and a refrigerated structure. The compressor room services both the main and additional facilities. The cold storage area of the addition is 64 feet by 160 feet and is approximately 25 feet high. It includes a 25-foot by 30-foot blast freezer area segmented off by movable wood partitions and a 25-foot by 25-foot area segmented off by wire mesh and referred to on blueprints as the "cage," which allows for the isolation of certain meats when so required by the U.S. Department of Agriculture (USDA). Equipment attached to the interior of the main facility and the addition includes storage racks, refrigeration coils and blowers, and piping from the compressor room. The equipment is attached in a manner similar to the equipment in the LR-Omaha addition.

The costs incurred with regard to the main facility placed in service on or about December 1, 1979, were as follows:

		Cost
Building		
Mezzanine, offices and dock areas		$298,352.28
Freezer/cooler areas		
Structure	$913,237.86	
Refrigeration equipment	153,455.43	1,066,693.29
Land improvements		
Truck turn-around area	116,231.68	
Customer and employee parking and landscaping	74,565.47	190,797.15
Non-refrigeration equipment		
Dock levelers	10,979.10	
Other	198,648.48	209,627.58
Furniture and fixtures		3,284.45
Total cost		1,768,754.75

The costs of the additions placed in service on or about March 1, 1980, were as follows:

		Cost
Building		
Lessee alterations	$22,493.39	
New docks	45,411.44	$67,904.83
Freezer/cooler areas		
Structure	198,505.89	
Refrigeration equipment	53,347.52	251,853.41
Railroad trackage		65,023.12
Land improvements		
Landscaping		1,195.32
Non-refrigeration equipment		
Sinks and lavatories	2,728.00	
Other	198,288.94	201,016.94
Furniture and fixtures		
Artwork	478.65	
Other	3,241.30	3,719.95
Total cost		590,713.57

On November 1, 1980, Millard-D placed in service a refrigerated structure in Denison, Iowa, including a truck turn-around and railroad spur to the facility. The design and construction of the facility, to provide for the cold storage of meats and other products, were similar to the other refrigerated structures described above. The facility is rectangular in shape, 227 feet by 194 feet, and 25 feet in height. It includes truck and railroad docks, a mezzanine area with offices, a compressor room, a pork processing room including a meat inspection room for Federal inspectors, and a cold storage area. The cold storage area of the facility is 192 feet by 192 feet, including an engine room of 32 feet by 32 feet. The cold storage facility contains two cooler rooms, 64 feet by 96 feet each, and three blast freezers, 30 feet by 32 feet each.

The costs of the Millard-D facility were as follows:

		Cost
Building		
Mezzanine, offices and dock areas		$157,097.99
Freezer/cooler areas		
Structure	$798,649.64	
Refrigeration equipment	118,627.27	917,276.91
Land improvements		
Truck turn-around area	23,839.21	
Customer and employee parking	4,767.84	28,607.05
Railroad Trackage		57,011.82
Non-refrigeration equipment		
Dock levelers	3,397.57	
Telephone-pager system	4,571.25	
Other	239,480.74	247,449.56
Office equipment		
Art work	873.00	
Other	5,455.40	6,328.40
Transportation equipment–auto		2,800.00
Total cost		1,416,571.73

Storage racks in the LR-Omaha, Millard-DM, and Millard-D cold storage facilities were designed to facilitate the circulation of air over and around the meat and other products. Although the storage racks could be removed without damage to the structures, holes in the floors of the structures where the storage racks are bolted would have to be plugged if the racks were removed. The facilities included special lighting systems adaptable to extremely low temperatures and elaborate sprinkler systems, designed so that water would not freeze in the pipes. The refrigeration equipment within each of the storage facilities, including the refrigeration coils and blowers or chiller units, could be removed from the facilities without damage to the structures. Where such equipment is installed on the roof, removal would leave screw holes.

Operation of the Facilities

The partnerships prepared a "Cold Storage TARIFF," or schedule of rates and charges, for 1979 and 1980. These documents included information regarding operating hours, plant addresses, and effective dates. Contract terms and conditions for storage were described, including the following: (1) Tender For Storage - all goods shall be delivered properly marked and packed for handling; (2) Storage Period - goods are generally stored on a month-to-month basis; (3) Storage Rates and Insurance; (4) Handling Charges; (5) Delivery Requirements; (6) Liability; (7) Liens and Security Interests; and (8) Controlling Law. The schedules described the partnerships' handling rates and storage rates for the following products:

Coolers

1. Cheese
2. Butter and butter substitutes
3. Candy
4. Dried fruit
5. Shelled and unshelled nuts
6. Eggs - shelled and dried
7. Fruit juices
8. Horticultural goods
9. Lard
10. Meat - canned and smoked
11. Milk and cream (powdered)
12. Potatoes

Freezer

1. Candy
2. Eggs - canned and dried
3. Fish and seafoods
4. Fruit
5. Vegetables
6. Juices
7. Soups
8. Prepared and cooked foods
   a. Cakes
   b. Meat cuts
   c. Pastries
   d. Pies
   e. Rolls
   f. Waffles
   g. Ice cream
   h. Convenience foods
   i. Toppings
9. Meats
   a. Loose hams
   b. Cuts
   c. Pork bellies
   d. Carcasses
10. Potatoes - french fries
11. Poultry
12. Turkeys

Additional charges were described for, among other things, collection, distribution, extra labor, freezing, exports, inspection, and sorting.

Most of the space in the facilities was operated on a public storage basis. During 1979 and 1980, the partnerships handled as much as 20 million pounds of meat per week. Customers of the partnerships were primarily

packers such as Swift, Dupaco, Iowa Beef Packers, and Farmland Foods, which used the storage facilities in 1979 and 1980 to build inventories of certain products with seasonal demand, such as canned hams for Christmas, corned beef for St. Patrick's Day, and pork bellies for bacon having a high demand in summer months. Nearly all products received at the partnerships' storage facilities in 1979 and 1980 were boxed or packaged with labels or brand names of the processor printed or attached to the box. Such products, when received, were unloaded at the rail and truck docks by employees and placed on pallets. They were inventoried and assigned lot numbers and placed by forklift in numbered storage racks. Inventory cards were maintained for all shipments, and the inventory was generally handled on a first-in first-out (FIFO) basis. The packers normally retained title to the foods stored until they were sold and shipped out, except for the pork bellies, which were often traded as commodities on the exchange. Overall employee activity was minimal and consisted essentially of unloading, storing, and loading products.

The facilities served two functions. First, meat that was "hot," i.e., freshly cut, was frozen. It generally took 1 or 2 days, at most, to freeze meat, depending on whether the freezer or sharp freezer area was used. Second, meat and other products were stored at cold to extremely cold temperatures. Although the facilities sometimes turned over a complete inventory in a couple of weeks, many products remained in storage for months. The refrigeration equipment in each of the refrigerated structures was two-tiered, i.e., the equipment could provide for either cooler or freezer services. The cooler or cold storage areas

were maintained at temperatures of approximately 32 degrees. The freezer areas were maintained at about minus 10 degrees to minus 20 degrees. Some of the freezer areas included small sharp freezer areas designed for rapid freezing at minus 30 degrees to minus 40 degrees using high wind velocity.

The rail facilities at Millard-D and Millard-DM accommodated the partnerships' export business. The railroad tracks at Millard-DM were used for both in-shipments and out-shipments, but the railroad tracks at Millard-D were used almost exclusively for out-shipments.

Notices of Deficiency

In their returns for 1979 and 1980, petitioners claimed investment tax credits for certain of the partnerships' improvements and additions. Among the items claimed were (1) the cold storage facilities, which included the refrigerated structures, the refrigeration equipment, and other equipment and improvements; (2) the truck turn-around areas; and (3) the railroad trackage. The partnerships claimed depreciation expense deductions for the refrigerated structures, railroad tracks, and truck turn-arounds using the 200-percent-declining-balance method and useful lives of 15 years.

In his notices of deficiency, respondent allowed investment tax credits for the refrigeration equipment and the railroad trackage but disallowed credits for the refrigerated structures and the truck turn-arounds. In amendments to answers, respondent asserts that the railroad trackage is not eligible for investment tax credit.

Respondent also determined in his notices of deficiency that the partnerships must use (1) the 150-percent-declining-balance method for computing the allowances for depreciation of the refrigerated structures and the truck turn-arounds, and (2) useful lives of 33 1/3 years for computing the allowances for depreciation of the refrigerated structures and the railroad trackage.

The deficiencies determined in docket No. 32911-84 for fiscal years ended February 28, 1975, February 29, 1976, and February 28, 1979; in docket No. 32935-84 for taxable years 1976, 1977, and 1978; and in docket No. 33261-84 for taxable years 1976, 1977, and 1978 are attributable to the disallowance of investment credit carrybacks with respect to properties each of the partnerships placed in service during 1979 and 1980.

OPINION

Investment Tax Credit Issue

The primary issue for consideration is whether petitioners are entitled to investment tax credits under section 38 with respect to certain refrigerated structures, paved truck turn-around areas, and railroad tracks, all of which were placed in service during the years in issue. Resolution of this issue depends on whether any or all of the property may be characterized as "section 38 property" that is eligible for credit against Federal income tax under section 38.

The term "section 38 property" is defined in section 48(a)(1), which provides, in relevant part, as follows:

(1) IN GENERAL. – * * * the term "section 38 property" means –

(A) tangible personal property * * *, or

(B) other tangible property (not including a building and its structural components) but only if such property –

(i) is used as an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or * * *

* * * * * * *

(iii) constitutes a facility used in connection with any of the activities referred to in clause (i) for the bulk storage of fungible commodities (including commodities in a liquid or gaseous state), * * *

* * * * * * * * *

Such term includes only property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 3 years or more. * * *

Petitioners contend that the properties in question qualify as "other tangible property" pursuant to section 48(a)(1)(B). Specifically, petitioners argue that the properties are not buildings but, instead, that the properties are used as an integral part of production or, alternatively, that the properties constitute facilities that provide bulk storage of fungible commodities. See sec. 48(a)(1)(B)(i) and (iii). Petitioners bear the burden of proving entitlement to the claimed investment tax credits. *Munford, Inc. v. Commissioner*, 87 T.C. 463, 488 (1986); Rule 142(a), Tax Court Rules of Practice and Procedure.

Because the statute specifically excludes buildings from investment tax credit and because such a determination would obviate the need for further inquiry, we shall first address whether the refrigerated structures constitute buildings.

Building – Section 48(a)(1)(B)

The term "building" is defined in section 1.48-1(e)(1), Income Tax Regs., as follows:

(e) *Definition of building and structural components.* (1) Buildings and structural components thereof do not qualify as section 38 property. The term "building" generally means any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores. Such term includes any such structure constructed by, or for, a lessee even if such structure must be removed, or ownership of such structure reverts to the lessor, at the termination of the lease. Such term does not include (i) a structure which is essentially an item of machinery or equipment, or (ii) a structure which houses property used as an integral part of an activity specified in section 48(a)(1)(B)(i) if the use of the structure is so closely related to the use of such property that the structure clearly can be expected to be replaced when the property it initially houses is replaced. Factors which indicate that a structure is closely related to the use of the property it houses include the fact that the structure is specifically designed to provide for the stress and other demands of such property and the fact that the structure could not be economically used for other purposes. Thus, the term "building" does not include such structures as

oil and gas storage tanks, grain storage bins, silos, fractionating towers, blast furnaces, basic oxygen furnaces, coke ovens, brick kilns, and coal tipples.

This regulation was issued pursuant to section 38(b), which authorized the Treasury to "prescribe such regulations as may be necessary to carry out the purposes" of the investment tax credit provisions. It conforms to congressional understanding of the term "building" as described in the legislative history. See H. Rept. 1447, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 405, 516; S. Rept. 1811, 87th Cong., 2d Sess (1962), 1962-3 C.B. 707, 858-859. It is thus a legislative regulation, almost as binding as the statute itself. *Yellow Freight System, Inc. v. United States*, 538 F.2d 790, 795-796 (8th Cir. 1976).

The regulation defines "building" in terms of two tests, or a two-part test. The appearance test generally requires a "structure or edifice enclosing a space within its walls, and usually covered by a roof," and the function test generally requires the structure "to provide shelter or housing, or to provide working, office, parking, display, or sales space," or to provide a similar function. Sec. 1.48-1(e)(1), Income Tax Regs.; *Munford, Inc. v. Commissioner*, 87 T.C. at 479.

Many courts, including this Court, emphasize the function of a structure to determine whether it is a building. See *Munford, Inc. v. Commissioner*, 87 T.C. at 479-480, and cases cited therein. Other courts, including the Court of Appeals for the Eighth Circuit, to which an appeal in this case would lie, require that a structure satisfy both the appearance test and the function test to qualify as a building. *Yellow Freight System, Inc. v. United States*, 538 F.2d at 796-798; *Illinois Cereal Mills, Inc. v. Commissioner*, 789 F.2d 1234, 1238 (7th Cir. 1986); *A.C. Monk & Co. v. United States*, 686 F.2d 1058, 1061 (4th Cir. 1982).

In *Yellow Freight System*, the taxpayer sought investment tax credit for the cost of certain loading docks and inspection lanes. The issue was whether the property qualified as "other tangible property" under section 48(a)(1)(B). The District Court applied the function test and allowed the investment tax credit. It concluded that because of the specialized purpose of the property, i.e., that it facilitated the transfer of freight in the taxpayer's transportation business, the structures did not function as buildings under section 48(a)(1)(B). *Yellow Freight System, Inc. v. United States*, 413 F. Supp. 357, 367-368 (W.D. Mo. 1975). The Court of Appeals reversed, rejecting the District Court's application of the function test to the extent it ignored the appearance of the structure and to the extent it emphasized the nature of employee activity within the structure without consideration of the amount of human activity within the structure. 538 F.2d at 797. The court stated that the regulation and legislative history require consideration of both appearance and function, that the function test is no less "imprecise" than the appearance test, and that appearance and function are not mutually exclusive, i.e., "a given structure is designed to accommodate the functions for which it is to be used." 538 F.2d at 797-798.

In *Yellow Freight System*, the Court of Appeals applied both tests to the loading docks and inspection lanes and held that they each resembled buildings and functioned as buildings, thus denying investment tax credit to the taxpayer. Specifically, the court found that the property resembled buildings in that (1) they were permanent structures with substantial dimensions, and (2) they were not uniquely designed, or structurally different, from

other buildings. (That neither the docks nor the inspection lanes had clearly discernible walls was not regarded as controlling by the court because the definition in the regulation furnishes only a general description of buildings.) The court also found that the property functioned as buildings in that the property essentially provided shelter and work space for men and equipment. 538 F.2d at 796.

Petitioners argue that the elements persuading the court in *Yellow Freight System* that the properties therein were buildings are not present in this case, i.e., (1) the refrigerated structures here are uniquely designed and uniquely functional, (2) they do not provide shelter or working space, and (3) to convert the refrigerated structures to an alternative use would require major structural and building material changes as well as prohibitive costs. Petitioners contend that because of these factors the refrigerated structures are not buildings as that term is defined for purposes of section 48(a)(1)(B).

Applying the appearance test of the regulation as mandated by *Yellow Freight System*, and *Golsen v. Commissioner*, 54 T.C. 742 (1970), affd. 445 F.2d 985 (10th Cir. 1971), we conclude that the refrigerated structures in issue resemble buildings. We have examined photographs and blueprints of the structures and have considered the testimony of witnesses; the structures are permanent structures of substantial dimensions which enclose spaces surrounded by walls and covered by roofs. See sec. 1.48-1(e)(1), Income Tax Regs.; *Yellow Freight System, Inc. v. United States*, 538 F.2d at 796; *Munford, Inc. v. Commissioner*, 87 T.C. at 481.

Petitioners argue that the refrigerated structures do not appear as buildings because of their unique design. We agree that the structures were specially designed in order to meet their intended purpose, i.e., to freeze meats and other food products and to provide cold storage for them. These specialized or "unique" features, however, do not alter the building-like appearance of the structure. Although it might be possible for a structure to be so unique in its design that its appearance is not that of a building in the ordinary sense, such is not the case with the refrigerated structures in issue here.

We must next consider whether the refrigerated structures function as buildings. This Court recently applied the function test to determine whether refrigerated structures, similar to the ones in issue here, were buildings. *Munford, Inc. v. Commissioner,* 87 T.C. 463 (1986). Therein, we reiterated that the function test requires a determination of "whether the purpose of the structure at issue is a purpose ejusdem generis to the purposes described by example in section 1.48-1(e)(1), Income Tax Regs." 87 T.C. at 480, citing *Consolidated Freightways v. Commissioner,* 74 T.C. 768, 795 (1980), affd. on this issue 708 F.2d 1385 (9th Cir. 1983). We also stated:

In applying the functional test, a major focus of inquiry is whether the structure provides working space for employees which is more than merely incidental to the primary function of the structure. See, e.g., *Brown-Forman Distillers Corp. v. United States,* 205 Ct. Cl. [402] at 418, 499 F.2d [1263] at 1271 [Ct. Cl. 1974]; *Valmont Industries, Inc. v. Commissioner,* [73 T.C. 1059] *supra* at 1072 [1980]; *Scott Paper Co. v. Commissioner,* [74 T.C. 137] *supra* at 178 [1980]; *Catron v. Commissioner,* [50 T.C. 306] *supra* at 316 [1968]. In this regard, it is appropriate to consider both the quantity and quality of the human activity

within the structure. See *Consolidated Freightways, Inc. v. United States*, 223 Ct. Cl. [443] at 461, 620 F.2d [862] at 873 [Ct. Cl. 1980]; *Consolidated Freightways v. Commissioner*, 74 T.C. at 795; *Satrum v. Commissioner*, [62 T.C. 413] *supra* at 417 [1974]. * * * [*Munford, Inc. v. Commissioner*, 87 T.C. at 480.]

Applying the function test to the refrigerated structure in *Munford*, we concluded that the structure was not a building:

We think that the principal purpose or function of the refrigerated area is not to furnish working space for petitioner's employees, but rather, to provide an area in which frozen foods may be stored at low temperature. In contrast with the truck and rail loading platforms [also at issue in *Munford*], the refrigerated area of the Addition is maintained at a temperature which limits, rather than promotes, human activity. Due to the cold temperature, the activities of petitioner's employees are limited in both scope and duration. In the case of the Addition's refrigerated area, the structure itself serves the principal function of low temperature storage of products, and the activities of petitioner's employees are merely supportive of and ancillary to this function. Accordingly, we conclude that the refrigerated portion of the Addition is not a building under the functional test. [87 T.C. at 483.]

Petitioners argue that the facts in this case are virtually indistinguishable from those in *Munford* and that we should likewise conclude that the structures do not function as buildings. Respondent argues that *Munford* is inapplicable because, among other things, we there considered whether property was eligible for investment tax credit under section 48(a)(1)(A). Indeed, the analysis in this case clearly falls under section 48(a)(1)(B); however, the regulations and the applicable cases make no distinction in the definition of "building" for purposes of subparagraph (A) or subparagraph (B) of section 48(a)(1).

See *Munford, Inc. v. Commissioner*, 87 T.C. at 478 n. 9. We agree with petitioners that the facts are similar and that, in this case, the refrigerated structures do not function as buildings. Although "hot" or fresh meat was sometimes delivered to the facilities to be frozen and then stored, unlike the facts in *Munford* where the foodstuff was already frozen, the evidence does not indicate that significant human activity, of quantity or quality, took place in the refrigerated structures. The structures did not function as working space for employees and equipment; rather, the refrigerated structures functioned to freeze meat and provide low temperature storage space for the meat and other food products.

Our conclusion is consistent with the application of the function test in *Yellow Freight System, Inc. v. United States*, 538 F.2d 790 (8th Cir. 1976). In that case, the Court of Appeals for the Eighth Circuit found that the structures in issue, loading docks and inspection lanes, did not serve the purpose of expediting the transfer of freight but merely provided working space for the employees and equipment performing that function. 538 F.2d at 796. In this case, however, the refrigerated structures performed the function identified, not the employees.

Respondent argues that because we ultimately determined that the structure in *Munford* was "inherently permanent" and thus ineligible for investment tax credit under section 48(a)(1)(A) and section 1.48-1(c), Income Tax Regs., our determination therein that the structures were not buildings, i.e., did not function as buildings, is dictum and therefore not binding in this case. We disagree. Our resolution of the building issue in *Munford* was hardly a mere observation or remark of little bearing

on the ultimate decision. Rather, the building issue was, because of the language of the statute and regulations there in issue, properly a threshold question for consideration. The same is true in this case, although we are applying a different subparagraph of section 48(a)(1).

We have thus concluded that the refrigerated structures resemble buildings and function *not* as buildings. Because we understand the Court of Appeals for the Eighth Circuit to require that a structure appear *and* function as a building to be deemed a building under section 48(a)(1)(B),[3] we hold that the refrigerated structures are not buildings.[4]

---

[3] See *Stuppy, Inc. v. United States*, 454 F. Supp. 1378, 1385 (W.D. Mo. 1978) (greenhouses are not buildings under either the appearance or function test); *Starr Farms, Inc. v. United States*, 447 F. Supp. 580 (W.D. Ark. 1977) (chicken houses appear and function as buildings in Eighth Circuit despite cases in other circuits and Tax Court holding otherwise). See generally *Valmont Industries, Inc. v. Commissioner*, 73 T.C. 1059 (1980).

[4] In addition to identifying an appearance test and function test for determining if a structure is a building, sec. 1.48-1(e)(1), Income Tax Regs., allows for two exceptions from the general definition of a building. The exceptions include (1) structures that are essentially machinery or equipment, or (2) certain structures that house property used in a qualifying activity under sec. 48(a)(1)(B)(i) if the structure and housed property are so closely related that they can be expected to be replaced together. Petitioners argue that their refrigerated structures fall with the first exception because they are essentially large refrigerator-freezers. Petitioners rely on Rev. Rul. 71-489, 1971-2 C.B. 64. Respondent argues that petitioners'

(Continued on following page)

Having concluded that the refrigerated structures are not buildings, we must now determine whether the refrigerated structures, the truck turn-arounds, and the railroad tracks otherwise qualify for investment tax credit under either section 48(a)(1)(B)(i) or section 48(a)(1)(B)(iii).

Integral Part of Production – Section 48(a)(1)(B)(i)

Petitioners maintain that the refrigerated structures, paved truck turn-arounds, and railroad tracks qualify for investment tax credit because they were used as an integral part of production within the meaning of section 48(a)(1)(B)(i). The regulations define "production" as follows:

(Continued from previous page)

structures do not refrigerate as machines or equipment but merely facilitate the operation of refrigeration equipment for which investment tax credits were allowed. Although petitioners do not affirmatively assert application of the second exception, respondent further argues that the property fails the second exception because it was reasonably adaptable to other commercial uses. Petitioners contend that any conversion to other uses would be unreasonable and uneconomical. Cf. *Munford, Inc. v. Commissioner*, 87 T.C. at 487-488. We have previously noted the confusion surrounding the application of the alternative use test. See *Munford, Inc. v. Commissioner*, 87 T.C. 463, 486-487 (1986), where we noted that reasonable adaptability has been considered for purposes of determining whether a structure is (1) a qualifying storage facility under sec. 48(a)(1)(B)(iii), (2) a structure housing qualifying property under sec. 1.48-1(e)(1)(ii), Income Tax Regs., and (3) a qualifying single purpose agriculture or horticulture structure under sec. 48(a)(1)(D). Because of the parties' exhaustive argumentation respecting these exceptions, we describe their positions thereon. Our conclusion that the structures are not buildings, however, precludes any need to address these arguments.

(2) *Manufacturing, production, and extraction.* For purposes of the credit allowed by section 38, the terms "manufacturing", "production", and "extraction" include the construction, reconstruction, or making of property out of scrap, salvage, or junk material, as well as from new or raw material, by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles, and include the cultivation of the soil, the raising of livestock, and the mining of minerals. Thus, section 38 property would include, for example, property used as an integral part of the extracting, processing, or refining of metallic and nonmetallic minerals, including oil, gas, rock, marble, or slate; the construction of roads, bridges, or housing; *the processing of meat*, fish, or other foodstuffs; the cultivation of orchards, gardens, or nurseries; the operation of sawmills, the production of lumber, lumber products or other building materials; the fabrication or treatment of textiles, paper, leather goods, or glass; and the rebuilding, as distinguished from the mere repairing, of machinery. [Sec. 1.48-1(d)(2), Income Tax Regs. Emphasis supplied.]

Petitioners argue that the property in issue was used as an integral part of the processing of meat. Petitioners thus contend that the freezing and ultimate storage of meat is a process, i.e., a qualifying activity. Petitioners rely on certain cases, including *Giannini Packing Corp. v. Commissioner*, 83 T.C. 526 (1984), and *Central Citrus Co. v. Commissioner*, 58 T.C. 365 (1972), for the proposition that the controlling of atmospheric conditions is essential to the production of agricultural products and the preparation of such products for shipment.

If we determine that the refrigerated structures were used as an integral part of processing and were therefore eligible for investment tax credit, respondent concedes the investment tax credits for all the truck turn-arounds and for the Millard-DM railroad tracks. Respondent does not, in like manner, concede the investment tax credit for

the Millard-D railroad tracks because he contends that the evidence shows that the Millard-D tracks were used only for out-shipments of food, not both in- and out-shipments like the tracks at Millard-DM. See sec. 1.48-1(d)(4), Income Tax Regs. Respondent argues, nevertheless, that neither the freezing nor storage of meat is a process as that term is defined for purposes of section 48(a)(1)(B)(i). Instead, respondent contends that the freezing and cold storage of meat is simply a "marketing process" (as compared to a qualifying manufacturing or production process) that merely extends the shelf life of the product.

In *Giannini Packing Corp. v. Commissioner, supra,* we allowed investment tax credits, holding that rooms in the taxpayer's packing plant used for cooling apples were an integral part of processing because they prevented the apples from dehydrating and shriveling and were otherwise essential to the taxpayer's production of fresh fruit. In *Central Citrus Co. v. Commissioner, supra,* we allowed investment tax credits, holding that taxpayer's "sweet rooms," wherein fruit incurred "degreening" as a result of specific atmospheric conditions involving temperature, humidity, gas, and air-movement control, were an integral part of the taxpayer's production of fresh fruit.

Petitioners offered the testimony of two food experts and respondent offered the testimony of one food expert. Although each expert described a different definition of the term "process," their reports and testimony all indicate that processing brings about a desired change to meet public safety standards or consumer demands. Petitioners' experts predictably state that the freezing of meat and its frozen storage constitute a continuing processing of the meat. They admit that freezing does not enhance

the quality of the individual cut of meat but suggest that its value is nevertheless increased. Respondent's expert stated that frozen storage of meat is not a process. He further noted, however, that he considered the initial freezing of meat to constitute a process. He thus concluded that the refrigerated structures in question provided two functions: a freezing as a process function and a freezer storage or warehousing function. A problem respondent's expert encountered was how or where to draw the line between these two functions. The facilities do not have separate rooms for the separate functions; instead, both functions occur in the same area(s), and often simultaneously.

Upon consideration of all the facts, including the extensive testimony by the food experts, we conclude that a "process" did not occur at petitioners' refrigerated structures within the meaning of the relevant statute and regulations. Although we have found the testimony of respondent's expert to be the most persuasive, we believe that the initial freezing function was secondary and merely a necessary step toward the primary function of the refrigerated structures, i.e., low temperature storage.

The cases relied upon by petitioners are distinguishable in that they represent situations where the food product incurred changes necessary, in those particular circumstances, for providing a desirable or finished product. Such changes included (1) the prevention of dehydration and shrinkage and the removal of ethylene gas in the production of fresh fruit (*Giannini Pack Corp. v. Commissioner, supra*), and (2) the necessary "degreening" of certain fruit (*Central Citrus Co. v. Commissioner, supra*). See also *Brown-Forman Distillers Corp. v. United States*, 205 Ct.

Cl. 402, 499 F.2d 1263 (1974), where the maturation of whiskey was determined a process because it aged the whiskey; and *Schuyler Grain Co. v. Commissioner*, 50 T.C. 265 (1968), affd. 411 F.2d 649 (7th Cir. 1969), where the aeration and drying of grain was determined a process because it improved the quality of the grain for its intended use. The freezing and storage of meat in petitioners' refrigerated structures simply did not render a change in the product consistent with the decided cases. We therefore hold that in this case the freezing and cold storage of meat was not a "processing of meat" that qualifies for investment tax credit under section 48(a)(1)(B)(i).[5]

In *Loda Poultry Co. v. Commissioner*, 88 T.C. 816 (1987), filed this date, we also held that the cold storage of meat was not a "processing of meat" that qualifies for investment tax credit regarding certain compartments in the taxpayer's refrigerated structure. Specifically, investment tax credit was denied for a zero-degree compartment and a 28-degree compartment where storage in such compartments was not part of a qualifying activity. The credit was allowed, however, for a 32-degree compartment. Insofar as that particular compartment is concerned, *Loda Poultry* is factually distinguishable from this case. The taxpayer in *Loda Poultry* was otherwise engaged in processing meat, i.e., chickens were cut, cleaned, inspected,

---

[5] We note that freezing of meat might be considered a process or part of a process in other circumstances, such as where a taxpayer was seeking a desired texture of the meat facilitating grinding or chopping. Such is not the case here.

and packaged in a 55-degree compartment of the structure, and then stored, to prevent spoilage, in the 32-degree compartment as the final step in the on-premises processing before the chickens were sold and shipped out. We therefore concluded that the 32-degree compartment was an "integral part of * * * [taxpayer's] production." See sec. 48(a)(1)(B)(i). In this case, petitioner is not otherwise engaged in what may be considered a qualifying activity, for which storage in any of the refrigerated structures might be deemed a necessary final step.

Bulk Storage of Fungible Commodities – Section 48(a)(1)(B)(iii)

Petitioners contend that the refrigerated structures were facilities used for the bulk storage of fungible commodities within section 48(a)(1)(B)(iii) That section, however, also requires that such storage be in connection with any of the qualifying activities identified under section 48(a)(1)(B)(i). We have already determined that petitioners' refrigerated structures were not used in a qualifying activity, and the evidence does not otherwise indicate a qualifying activity occurring at petitioners' businesses. Petitioners are therefore precluded from investment tax credits under section 48(a)(1)(B)(iii).

Even if the facilities were used in a qualifying activity, petitioners nevertheless fail to qualify for investment tax credit under section 48(a)(1)(B)(iii). The refrigerated structures were not used for the "bulk storage of fungible commodities." Bulk storage is described in section 1.48-1(d)(5)(ii), Income Tax Regs., as follows:

Bulk storage means the storage of a commodity in a large mass prior to its consumption or utilization. Thus, if a facility is used to store oranges that have been sorted and boxed, it is not used for bulk storage.

Applying the regulation to the facts in this case, the meats and other food products, which were boxed and labeled, were not stored in bulk.

In *Merchants Refrigeration Co. of California v. United States*, 659 F.2d 116 (9th Cir. 1981), investment tax credit was not allowed where goods stored in the taxpayer's facilities were identified as to individual owner, who segregated the food and retained control over its ultimate disposition. The court held that the goods were not fungible because, among other things, ownership of such goods was not "in common." Petitioners attempt to distinguish this case but fail. The evidence in this case, including photographs, indicates that the meats and other products were containerized, identified, and segregated by owner. The products therefore were not fungible.

Depreciation Issues

The second issue for consideration is whether the partnerships may use the 200-percent-declining-balance method for computing the allowances for depreciation of the refrigerated structures and truck turn-arounds. The parties agree that our resolution of the investment tax credit issue would also determine this issue. Compare sec. 48(a)(1) with sec. 1245(a)(3). See sec. 1.1245-3(c), Income Tax Regs.

Section 167(b)(2) generally permits taxpayers to use the double-declining-balance method for computing an allowance for depreciation. In the case of "section 1250 property," however, section 167(j)(1) limits the declining-balance method to a rate not exceeding 150 percent. Sec. 167(j)(1)(B). The term "section 1250 property" is defined as "any real property (other than section 1245 property, as defined in section 1245(a)(3))" which is or has been depreciable under section 167. Sec. 1250(c).

The term "section 1245 property" is defined in section 1245(a)(3) as follows:

> (3) SECTION 1245 PROPERTY. – For purposes of this section, the term "section 1245 property" means any property which is or has been property of a character subject to the allowance for depreciation provided in section 167 (or subject to the allowance of amortization provided in section 185) and is either –
>
> (A) personal property,
>
> (B) other property (not including a building or its structural components) but only if such other property is tangible and has an adjusted basis in which there are reflected adjustments described in paragraph (2) for a period in which such property (or other property) –
>
> (i) was used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or
>
> (ii) constituted a research facility used in connection with any of the activities referred to in clause (i), or
>
> (iii) constituted a facility used in connection with any of the activities referred to in clause (i) for

the bulk storage of fungible commodities (including commodities in a liquid or gaseous state),

(C) an elevator or an escalator, or

(D) so much of any real property (other than any property described in subparagraph (B)) which has an adjusted basis in which there are reflected adjustments for amortization under section 169, 185, 188, 190, 193, or 194.

Subparagraph (B) of section 1245(a)(3) essentially tracks the language in subparagraph (B) of section 48(a)(1). Because we have already determined that the property in question was not eligible for investment tax credit under section 48(a)(1)(B) and because the property does not otherwise satisfy the definition of "section 1245 property," we conclude that the property is section 1250 property. Accordingly, the 200-percent-declining-balance method is not available for the refrigerated structures and truck turn-arounds. The partnerships must use the 150-percent-declining-balance method.

The third issue for consideration is whether the partnerships may compute the allowances for depreciation of the refrigerated structures and railroad tracks based on useful lives of 15 years, as claimed by petitioners, or 33 1/3 years, as determined by respondent. Petitioners bear the burden of proving error in respondent's determination. *Casey v. Commissioner*, 38 T.C. 357, 381 (1962).

Section 1.167(a)-1(b), Income Tax Regs., defines "useful life," in pertinent part, as follows:

(b) *Useful life.* For the purpose of section 167 the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful

to the taxpayer in his trade or business or in the production of his income. This period shall be determined by reference to his experience with similar property taking into account present conditions and probable future developments. Some of the factors to be considered in determining this period are (1) wear and tear and decay or decline from natural causes, (2) the normal progress of the art, economic changes, inventions and current developments within the industry and the taxpayer's trade or business, (3) the climatic and other local conditions peculiar to the taxpayer's trade or business, and (4) the taxpayer's policy as to repairs, renewals, and replacements. Salvage value is not a factor for the purpose of determining useful life. If the taxpayer's experience is inadequate, the general experience in the industry may be used until such time as the taxpayer's own experience forms an adequate basis for making the determination. * * *

Respondent's engineering experts examined the refrigerated structures and estimated their useful lives, economic and physical, in the range of 35 to 45 years. Respondent argues that a 15-year useful life is not consistent with the 33 1/3-year useful life claimed by the partnerships for other structures and building improvements, i.e., docks, mezzanines, and offices, and that petitioners rely solely on the testimony of petitioner Larry Larsen.

The quoted regulation, however, indicates that the best source for determining useful life is the taxpayers's own experience, if any. Petitioner Larry Larsen, unlike respondent's experts, has constructed and maintained refrigerated structures for approximately 25 years. He testified that the structures incur substantial wear and tear, especially the roof and the insulation. He also noted that technological advances render certain of the specialized materials obsolete in a matter of years. Although respondent's experts disagreed with petitioner Larry

Larsen, we were nevertheless more persuaded by his testimony. His testimony as to the useful life of such structures was articulate, credible, and more convincing. The useful life of the refrigerated structures is thus 15 years for purposes of computing the allowance for depreciation.

Respondent correctly notes that petitioners offer no evidence regarding the useful life of the railroad tracks; moreover, petitioners' briefs are silent on the issue. Petitioners have thus failed to meet their burden of proof, and respondent's determination as to the useful life of the railroad tracks must be sustained.

Decisions will be entered under Rule 155.

APPENDIX E

UNITED STATES TAX COURT

L & B CORPORATION, a Nebraska corporation,	)	
Petitioner,	)	
v.	)	Docket No. 32911-84
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

DECISION

Pursuant to the opinion of the Court filed April 6, 1987, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED and DECIDED: That there are deficiencies in income taxes due from the petitioner for the fiscal years ended February 28, 1975, February 29, 1976, February 28, 1979, February 29, 1980, and February 28, 1981, in the amounts of $10,353.89, $307.58, $18,991.04, $18,591.01 and $2,954.77, respectively.

(Signed) Mary Ann Cohen
Judge.

Entered: AUG 6 1987

* * *

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision without prejudice to the right of either party to contest the correctness of the decision entered herein.

WILLIAM F. NELSON
Chief Counsel
Internal Revenue Service

/s/ Truman Clare
TRUMAN CLARE
Counsel for Petitioner
American Charter Center
1623 Farnam Street,
Suite 900
Omaha, Nebraska 68102
Tel. No. (402) 422-0900

Date: July 29, 1987

By: (Signed) Ronald M. Frykberg
RONALD M. FRYKBERG
District Counsel
P. O. Box 1500
Downtown Station
Omaha, Nebraska 68101
Tel. No. (402) 221-3733

Date: JUL 29 1987

UNITED STATES TAX COURT

LARRY A. LARSEN and BETTY J. LARSEN,	)	
Petitioners,	)	
v.	)	Docket No. 32935-84
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

DECISION

Pursuant to the opinion of the Court filed April 6, 1987, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED and DECIDED: That there are deficiencies in income taxes due from the petitioners for the taxable years 1976, 1977, 1978, 1979, and 1980 in the amounts of

$9,301.73, $22,770.73, $13,916.15, $23,553.70 and $6,102.16, respectively.

(Signed) Mary Ann Cohen
Judge.

Entered: AUG 6 1987

* * *

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision without prejudice to the right of either party to contest the correctness of the decision entered herein.

WILLIAM F. NELSON
Chief Counsel
Internal Revenue Service

/s/ Truman Clare
TRUMAN CLARE
Counsel for Petitioners
American Charter Center
1623 Farnam Street,
Suite 900
Omaha, Nebraska 68102
Tel. No. (402) 422-0900

Date: July 29, 1987

By: (Signed) Ronald M. Frykberg
RONALD M. FRYKBERG
District Counsel
P. O. Box 1500
Downtown Station
Omaha, Nebraska 68101
Tel. No. (402) 221-3733

Date: JUL 29 1987

UNITED STATES TAX COURT

ESTATE OF HOWARD C. LARSEN, Deceased, MAXINE J. LARSEN, Executrix, and MAXINE J. LARSEN, Petitioners,	)	
v.	)	Docket No. 33261-84
COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	

DECISION

Pursuant to the opinion of the Court filed April 6, 1987, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED and DECIDED: That there are deficiencies in income taxes due from the petitioners for the taxable years 1976, 1977, 1978 and 1979 in the amounts of $6,803.23, $1,903.85, $11,843.21 and $25,996.80, respectively; and

That there is a deficiency in income tax due from the petitioners for the taxable year 1980 in the amount of $15,810.74, without taking into consideration a tentative investment credit carryback allowance from the taxable year 1983 made on October 15, 1984, under the provisions of 1954 I.R.C. § 6411.

(Signed) Mary Ann Cohen
Judge.

Entered: AUG 6 1987

* * *

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision without prejudice to the right of either party to contest the correctness of the decision entered herein.

WILLIAM F. NELSON
Chief Counsel
Internal Revenue Service

/s/ Truman Clare
TRUMAN CLARE
Counsel for Petitioners
American Charter Center
1623 Farnam Street,
Suite 900
Omaha, Nebraska 68102
Tel. No. (402) 422-0900

Date: July 29, 1987

By: (Signed) Ronald M. Frykberg
RONALD M. FRYKBERG
District Counsel
P. O. Box 1500
Downtown Station
Omaha, Nebraska 68101
Tel. No. (402) 221-3733

Date: JUL 29 1987

APPENDIX F

§ 1.48-1 Definition of section 38 property

* * *

(e) **Definition of building and structural components.** (1) Buildings and structural components thereof do not qualify as section 38 property. The term "building" generally means any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores. Such term includes any such structure constructed by, or for, a lessee even if such structure must be removed, or ownership of such structure reverts to the lessor, at the termination of the lease. Such term does not include (i) a structure which is essentially an item of machinery or equipment, or (ii) a structure which houses property used as an integral part of an activity specified in section 48(a)(1)(B)(i) if the use of the structure is so closely related to the use of such property that the structure clearly can be expected to be replaced when the property it initially houses is replaced. Factors which indicate that a structure is closely related to the use of the property it houses include the fact that the structure is specifically designed to provide for the stress and other demands of such property and the fact that the structure could not be economically used for other purposes. Thus, the term "building" does not include such structures as

oil and gas storage tanks, grain storage bins, silos, fractionating towers, blast furnaces, basic oxygen furnaces, coke ovens, brick kilns, and coal tipples.

No. 88-1649

(2)

Supreme Court, U.S.
FILED
MAY 23 1989
JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1988

L & B CORPORATION, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

WILLIAM C. BRYSON
Acting Solicitor General
JAMES I.K. KNAPP
Acting Assistant Attorney General
ANN BELANGER DURNEY
THOMAS R. LAMONS
Attorneys
Department of Justice
Washington, D.C. 20530
(202) 633-2217

15 pp

QUESTION PRESENTED

Whether the refrigerated structures placed in service by petitioners in 1979 and 1980 were "building[s]" within the meaning of 26 U.S.C. 48(a)(1)(B), rendering them ineligible for the investment tax credit.

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In the Supreme Court of the United States

OCTOBER TERM, 1988

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L & B CORPORATION, ET AL., PETITIONERS

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COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-21) is reported at 862 F.2d 667. The opinion of the Tax Court (Pet. App. 25-59) is reported at 88 T.C. 744.

JURISDICTION

The judgment of the court of appeals (Pet. App. 22-23) was entered on November 25, 1988. A petition for rehearing was denied on January 6, 1989 (Pet. App. 24). The petition for a writ of certiorari was filed on April 4, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioners were partners in three partnerships that owned and operated several cold storage warehouse facil-

ities in Nebraska and Iowa (Pet. App. 2, 4). They claimed investment tax credits based upon their distributive shares of the partnerships' cost of constructing or improving several refrigerated structures that were placed in service in 1979 and 1980 (*id.* at 3). Each structure is constructed of conventional building materials – including poured concrete footings and floors, walls of concrete block or insulated metal panels attached to steel framing, and an insulated steel decking roof. Beneath the concrete floor is a six-inch layer of insulation on top of a layer of gravel. Pipes within the gravel layer remove waste heat from the compressors and prevent frost build-up that could cause the floor to buckle. Each structure contains refrigeration equipment (coils and blowers) and storage racks, which can be removed without damaging the structure. *Id.* at 4-5, 29-31.

The predominant use of the facilities is to "blast freeze" freshly cut meat delivered to the facilities by meat packers. Upon arrival, the meat is placed on pallets and taken into the structures for rapid freezing. The meat is then moved to other refrigerated areas for storage until shipment. The facilities are also used to store frozen food products. The meat and other food products are transported to and from the various refrigerated compartments by employees using fork lifts. Pet. App. 5-6, 36-37.

On audit, the Commissioner determined that an investment credit for the costs of the refrigeration equipment should be allowed. He disallowed the credit for the costs of constructing the structures themselves, however, reasoning that they were "buildings" ineligible for the credit and also that they were not used in manufac-

turing, production, or extraction, as required by 26 U.S.C. 48(a)(1)(B)(i). Pet. App. 3, 38-39.[1]

2. Petitioners sought redetermination of the resulting deficiencies in the Tax Court, which ruled in favor of the Commissioner (Pet. App. 25-59). The court first held that the refrigerated structures were not "buildings" within the meaning of Section 48(a)(1)(B) and therefore were not disqualified from the investment tax credit on that ground (Pet. App. 41-49). The court reasoned that, while the structures looked like buildings (*id.* at 44-45), they did not function as buildings because they did not provide working space for employees (*id.* at 47). The Court nonetheless denied petitioners' claimed investment credit on the ground that none of the property was used in a qualifying production activity as required by Section 48(a)(1)(B)(i) (Pet. App. 49-54).

3. The court of appeals affirmed in part and reversed in part (Pet. App. 1-21). First, contrary to the Tax Court, the court held that the refrigerated structures were "buildings" and therefore ineligible for the investment credit (*id.* at 8-16). The court rejected as "unduly restrictive" the Tax Court's view that a structure could not function as a building if it did not primarily provide working space for humans (*id.* at 9). Citing the definition

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[1] The Commissioner also denied the credit for the cost of the truck turnarounds and railroad tracks added to the facilities, because they were not used in an activity qualifying under Section 48(a)(1)(B)(i). Because the structures did not qualify as property eligible for the investment tax credit ("Section 38 property"), the Commissioner also determined that petitioners were not entitled to use the double declining balance method of depreciation, pursuant to Sections 167, 1250 and 1245 of the Internal Revenue Code (26 U.S.C.). See Pet. App. 55-59.

of "building" in Treas. Reg. § 1.48-1(e)(1), and the legislative history that instructs that the term "building" be given its commonly accepted meaning, the court concluded that "a structure functions as a 'building' if it provides shelter for significant machine or animal activity or if it provides working space for humans" (Pet. App. 12). The court held that the refrigerated structures in this case function as buildings because they provide shelter for significant machine activity, as well as working space for the employee activity required (*id.* at 12, 21).

The court of appeals also disagreed (Pet. App. 17-21) with the Tax Court's conclusion that the facilities were not used as an integral part of a qualifying activity, *i.e.*, "manufacturing, production, or extraction," which had been the basis for the Tax Court's complete denial of the claimed investment credit. The court of appeals held that the blast freezing of fresh meats constitutes part of "the processing of meat" within the meaning of the relevant Treasury Regulations (see *id.* at 17-20). Accordingly, the court concluded that the portions of the warehouse facilities that were not "buildings," *i.e.*, the truck turnarounds and railroad trackage, did qualify for the investment credit as "other tangible property" used as an integral part of a qualifying activity, and it reversed the Tax Court to that extent (*id.* at 21).[2]

ARGUMENT

The court of appeals correctly rejected petitioner's claim of entitlement to an investment credit for its refrigerated structures. The decision below does not conflict with any decision of this Court and does not conflict in

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[2] The government has not sought certiorari on this issue.

result with any decision of another court of appeals. Moreover, the issue presented here lacks continuing importance because the investment credit provisions were repealed in 1986 and do not apply to property placed in service after 1985. Accordingly, review by this Court is not warranted.

1. The investment tax credit was repealed by Section 211(a) of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2166. Pursuant to that statutory change, the investment tax credit is not available for property placed in service after December 31, 1985. See 26 U.S.C. 49 (Supp. V 1987). Thus, the question presented in this case – the definition of a "building" under 26 U.S.C. 48(a)(1)(B) – is relevant only to a dwindling number of cases concerning property placed in service prior to 1986.

Petitioners argue (Pet. 18-19) that the correct standard for determining whether a structure is a "building" retains prospective importance for purposes of deciding whether the structure is eligible for accelerated depreciation. The rules applicable to depreciation of tangible property used in a trade or business have been substantially revised since the tax years involved in this case. See 26 U.S.C. 168 (1982 & Supp. V 1987).[3] These new rules specify that "nonresidential real property"

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[3] The new accelerated depreciation rules were established by Sections 201-214 of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 203-241. With limited exceptions, those rules apply to property placed in service after December 31, 1980. The accelerated depreciation rules were changed again, effective for property placed in service after December 31, 1986, by Section 201 of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2121-2142.

(§ 168(e)(2)(B)) is depreciable by the straight line method with a recovery period of 31.5 years, while other property may be eligible for accelerated depreciation (§§ 168(b)(3)(A) and 168(c)(1)). This case, however, does not involve the definition of "nonresidential real property" in the depreciation provisions, and there is no basis for necessarily equating that definition with the definition of "building" in the repealed investment tax credit provisions. Thus, this case does not present an opportunity to clarify the law on any question of prospective importance.

2. The court of appeals correctly held that the refrigerated structures at issue here were "buildings." The investment credit provisions of the Internal Revenue Code applicable to the tax years at issue here, 26 U.S.C. 38, 46 and 48, allowed a tax credit for investments in certain kinds of depreciable property. Section 48(a)(1)(A) provided that tangible personal property (other than an air conditioning or heating unit) qualified for the credit. Section 48(a)(1)(B) authorized a credit for "other tangible property" used in certain activities such as manufacturing or production, but this subsection expressly excluded "a building and its structural components." The statute contained no definition of "building," but the term was defined by Section 1.48-1(e)(1) of the Treasury Regulations as follows:

> any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses,

> barns, garages, railway or bus stations, and stores.

Based on this regulatory definition and the relevant legislative history, the courts developed a two-part test to determine if a structure was a building: (1) the "appearance" test, *i.e.*, whether the property resembled a building by enclosing a space with walls and a roof; and (2) the "function" test, *i.e.*, whether it provided shelter, housing, working, office, parking, display, or sales space. See, *e.g.*, *Consolidated Freightways, Inc.* v. *Commissioner*, 708 F.2d 1385 (9th Cir. 1983); *A.C. Monk & Co.* v. *United States*, 686 F.2d 1058, 1061 (4th Cir. 1982); *Yellow Freight System, Inc.* v. *United States*, 538 F.2d 790 (8th Cir. 1976).

As the court of appeals explained (Pet. App. 12), the refrigerated structures involved here are reasonably regarded as "buildings" under this approach. The legislative history indicates that Congress intended that the term "building" "is to be given its commonly accepted meaning, that is, a structure or edifice enclosing a space within its walls, and usually covered by a roof." See H.R. Rep. No. 1447, 87th Cong., 2d Sess. A18 (1962); S. Rep. No. 1881, 87th Cong., 2d Sess. 154 (1962). The structures here are enclosed with walls and a roof, and they function as a warehouse, which is specifically mentioned in the regulation and in the legislative history as a kind of building. See H.R. Rep. No. 1447, *supra*, at A18; S. Rep. No. 1881, *supra*, at 155. The structures clearly provide shelter for the refrigeration equipment and the employees who move the meat during the process of freezing, storing, and shipping it.

The Tax Court's holding that the structures in this case are not "buildings" rests upon its view that "a major focus of inquiry is whether the structure provides working space for employees which is more than merely incidental to the primary function of the structure" (Pet. App. 45 (internal quotation omitted)). Under that approach, the court found that they were not buildings because they did not provide for "significant human activity" within (*id.* at 46-47). The court of appeals correctly rejected this interpretation of the investment tax credit provisions. In the words of the court of appeals, "[n]othing, either in the Code or in the Regulations, implies that this space must be primarily occupied by humans to qualify as a building" (*id.* at 9). To the contrary, both the regulation and the legislative history make clear that edifices that primarily provide shelter for goods or machinery, such as warehouses and garages, can qualify as buildings. Thus, the court of appeals applied the correct legal standard to the undisputed facts of this case, and it correctly held that the refrigerated structures were buildings. It therefore did not err in affirming the Tax Court's denial of the claimed investment tax credit for the structures.

3. Contrary to petitioner's contention (Pet. 12-13), it is not appropriate for this Court to grant certiorari here to resolve an asserted conflict with *Munford, Inc.* v. *Commissioner*, 849 F.2d 1398 (11th Cir. 1988). In that case, as in this one, the court of appeals affirmed the Tax Court's holding that a refrigerated structure did not qualify for the investment tax credit. Unlike this case, however, the court there accepted the Tax Court's conclusion that the refrigerated structure was not a "building" (849 F.2d at 1402-1404); instead, the court affirmed the Tax Court's denial of the credit because it held that the struc-

ture could not qualify as "tangible personal property" under Section 48(a)(1)(A) because it was an "inherently permanent structure" that was not "in the nature of machinery" (849 F.2d at 1404-1407).[4] Thus, the Eleventh Circuit, the Eighth Circuit, and the Tax Court have all rejected the claim that refrigerated structures are eligible for the investment tax credit under the statute applicable to these tax years, albeit upon different rationales. This difference in reasoning to reach the same result does not present a conflict in the circuits that warrants the attention of this Court. Moreover, as noted earlier (point 1, *supra*), to the extent this difference in reasoning might lead to different results in another factual context, review by this Court is not appropriate because the investment tax credit has been repealed and the definition of "building" in the investment credit provisions is accordingly of diminishing importance.

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[4] The taxpayer in *Munford* relied exclusively on Section 48(a)(1)(A); it did not argue, as did petitioners here, that the structure qualified as "other tangible property" under Section 48(a)(1)(B).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

WILLIAM C. BRYSON
Acting Solicitor General
JAMES I.K. KNAPP
Acting Assistant Attorney General
ANN BELANGER DURNEY
THOMAS R. LAMONS
Attorneys

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